SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, ~~1959~~ 1960

No. ~~720~~ 42

SMALL BUSINESS ADMINISTRATION, PETITIONER,

v.

G. M. McCLELLAN, TRUSTEE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

INDEX

1 IN THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

No. 6117

SMALL BUSINESS ADMINISTRATION, *Appellant*

v.

G. M. McCLELLAN, TRUSTEE, *Appellee*

IN THE MATTER OF

S. H. BYQUIST, an individual doing business as WESTERN DISTRIBUTORS, Bankrupt

Statement of Points on Which Appellant Intends to Rely on Appeal—Filed March 20, 1959

The appellant, the United States of America, hereby states that in its appeal to the United States Court of Appeals for the Tenth Circuit from the Order and Judgment of January 28, 1959, in favor of the trustee and against the petitioner, it intends to rely upon the following points:

1. The district court erred in denying the Small Business Administration priority with respect to that part of its claim which constituted an indebtedness of the bankrupt to the Small Business Administration prior to the adjudication of bankruptcy.

2. The district court erred in holding that there was no debt owing the Small Business Administration by the bankrupt until after the adjudication of bankruptcy.

3. The district court erred in approving and affirming the referee's order denying the Small Business Administration a priority on its claim.

2 WILBUR G. LEONARD
United States Attorney
District of Kansas
Topeka, Kansas
Attorney for Appellant

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF KANSAS

S. H. BYQUIST, an individual, doing business as Western Distributors, Bankrupt.

SMALL BUSINESS ADMINISTRATION, Claimant,

v.

G. M. McCLELLAN, Trustee.

Bkcy. No. 1138-B-1

Proof of Claim in Bankruptcy—Filed Oct. 15, 1957

State of Missouri County of Jackson ss.

GEORGE E. DEPEW, of 911 Walnut Street, in Kansas City, County of Jackson, State of Missouri, being first duly sworn upon his oath deposes and says:

1. That the claimant, the United States of America, is a corporate sovereign and body politic. That the Small Business Administration, whose principal officer is Wendell B. Barnes, Administrator, Small Business Administration, Washington, D. C., maintains its Ninth Regional Office at 911 Walnut Street, Kansas City 6, Missouri, and is a duly authorized agency of the United States of America at all times hereinafter mentioned.

2. That deponent is the duly appointed, qualified and Acting Regional Director of Small Business Administration, an independent agency of the United States Government; that deponent is duly authorized under
4 instrument of authority published in the Federal Register on April 18, 1956 (21 F.R. 2544), incorporating by reference that published August 13, 1954 (19 F.R. 5119), and that published July 17, 1954 (19 F.R. 4433), to make this proof of claim.

3. That above-named bankrupt is fully and duly indebted to said Small Business Administration in the sum of Sixteen Thousand Seven Hundred Eighty-Eight and 42/100 ($16,788.42) Dollars; said sum represents the total indebtedness due and payable by bankrupt by virtue of the failure to repay to Small Business Administration the

indebtedness arising from the loan made by the Brookville State Bank, Brookville, Kansas, to said bankrupt; said sum consists of Sixteen Thousand Four Hundred Sixty-Two and 31/100 ($16,462.31) Dollars principal due, and Three Hundred Twenty-Six and 11/100 ($326.11) Dollars as interest due to but not including October 16, 1957, and that thereafter the daily interest accrual on the principal is $2.7437.

4. That the consideration of said indebtedness is as follows:

(a) A Note in the principal amount of $20,000.00, duly executed and delivered to the said bank and thereafter assigned to the Small Business Administration pursuant to the Participation Agreement, attached as "Exhibit A". Attached hereto and made a part hereof and marked "Exhibit B" is a photostatic copy of the above-mentioned Note.

5. That the said S. H. Byquist has defaulted on the terms and conditions of the Note designated as "Exhibit B" and that there is now due and owing the aforesaid sum by virtue of said default.

6. This claim is filed as a Priority Claim.

UNITED STATES OF AMERICA, *Claimant*

By WENDELL B. BARNES, *Administrator*
Small Business Administration

By GEORGE E. DEPEW,
Acting Regional Director

[Seal]

Subscribed and sworn to before me this 15th day of October, 1957.

RITA E. HUTCHIN, *Notary Public*

My Commisson expires September 1, 1958.

Filed October 15, 1957 E. R. Sloan, Referee By H. Kerle

Exhibit A to Proof of Claim

United States of America Small Business Administration, Washington 25, D. C.

Participation Agreement (For Immediate Participation by SBA in Loan Made by Bank).

Agreement made this 19th day of November, 1956, by and between Brookville State Bank (Name of bank), Brookville (Name of town), Kansas (State), (hereinafter referred to as "Bank") and Small Business Administration (hereinafter referred to as "SBA"):

Whereas, S. H. Byquist, d/b/a Western Distributors (Name of borrower), Salina (Name of town), Kansas (State), (hereinafter referred to as "Borrower"), has made application for a loan in the amount of $20,000.00 (hereinafter referred to as "Loan") and SBA desires to purchase a participation of 75 per cent of the Loan or such part thereof as Bank may disburse to Borrower:

Now, Therefore, in consideration of their mutual promises, Bank and SBA represent and agree as follows:

1. Conditions for Disbursement.—Loan shall be disbursed by Bank subject to the terms and conditions set forth in the authorization of SBA dated November 2, 1956, and all amendments and modifications thereof made and sent to Bank prior to the date of the first disbursement on account of the Loan (which authorization and amendments and modifications are hereinafter collectively referred to as "Authorization").

6 2. Purchase of Participation.—SBA, upon written demand by Bank, will purchase from Bank a participation of 75 per cent of each disbursement made by Bank to Borrower on account of the Loan, immediately after such disbursement, for an amount of money equal to the amount of said participation. Immediately upon each such purchase, Bank will execute and deliver to SBA a Participation Certificate on SBA Form 152* evidencing the interest in the Loan so purchased.

3. Voluntary Purchase Privilege.—Bank may at its option at any time purchase SBA's total participating interest in the Loan by giving written notice to SBA

that it will do so ten days after receipt by SBA of said notice. At the time of such purchase, Bank shall pay therefor an amount of money equal to that portion of the amount then owing on account of the Loan (including appropriate adjustment for interest and charges computed to the date of said purchase), which represents SBA's participating interest. Simultaneously with said purchase, SBA shall (a) deliver to Bank each Participation Certificate it received from Bank pursuant to paragraph 2 hereof, (b) release Bank, in a manner satisfactory to Bank, from all liability under this Agreement, and (c) if the Note, collateral and instruments have been transferred to SBA as provided in paragraph 11 hereof, transfer to Bank, without recourse, the Note, collateral and instruments previously received by SBA from Bank, upon receipt by SBA of the Certificate of Interest, delivered pursuant to paragraph 11 hereof.

4. Disposition of SBA Check. — Bank will neither endorse nor transfer any check issued to it by SBA on account of the purchase of SBA's agreed participation in a disbursement to be made by Bank until Bank has disbursed to Borrower the amount it represents it will disburse to Borrower in Bank's requisition to SBA for such check, and Bank will either endorse such check not later than ten days from the date thereof and apply the proceeds thereof in payment of SBA's agreed participation in such disbursement, or will return such check to SBA.

5. Fees and Commission.—Bank has not directly or indirectly charged or received, and will not charge, any bonus, fee, commission, or expense in any form in connection with the making of the Loan, except such charges and expenses for actual services.

6. Sharing of Collateral.—Any and all security or guaranty of any nature which Bank or SBA now holds or may receive further to secure Bank or SBA with respect to the Loan shall secure the interests of both Bank and SBA in the Loan; provided that Bank or SBA may release any collateral other than that required by the Authorization.

7. Assignment of Interest in Loan.—Neither party will assign, in whole or in part, its interest in the Loan without the prior written consent of the other party.

8. First Disbursement.—Prior to the first disbursement to Borrower on account of the Loan, Bank shall receive:

(a) Borrower's Loan Agreement and the Note (on SBA Form 326*) instruments of hypothecation (containing covenants with respect to the payment of taxes and other charges which constitute prior liens on any real or personal property required as collateral and premiums on the insurance policies required pursuant to paragraph 8 (b) hereof) agreements, documents, and evidence required by the Authorization as a condition to such disbursement.

(b) Insurance policies covering the property constituting collateral for the Note against such risks and in such amounts and form and issued by such companies as shall be satisfactory to Bank, containing appropriate loss payable clause in favor of the holder of the Note as its interest may appear.

(c) Opinion of Bank's counsel that: (i) each of the agreements, hypothecations, and documents required by the authorization as a condition to such disbursement is a valid and binding obligation in accordance with its terms and (when recordation or filing is appropriate or requisite) has been duly filed or recorded; and (ii) all hypothecations of collateral (except in so far as they purport to cover after-acquired property) required by the Authorization as a condition to such disbursement constitute valid first liens upon the respective properties and rights covered thereby: Provided, however, That such opinion may reserve appropriate exception with respect to prior liens for taxes not due and payable, prior liens expressly permitted by the Authorization and other matters deemed immaterial by Bank and Bank's counsel.

8 (d) Evidence satisfactory to Bank that there has been no adverse change since the date of the last financial statement submitted by Borrower to Bank in Borrower's financial condition, organization, operations, business prospects, fixed properties or personnel suffi-

ciently serious in the opinion of Bank to warrant withholding disbursement on account of the Loan, or that any such adverse change in Borrower's financial condition has been remedied to the satisfaction of Bank by contributions without liability therefor and/or issuance of shares of Borrower's capital stock and/or loans as to which standby agreements covering principal and interest have been executed substantially in the form of SBA Form 155*.

9. Subsequent Disbursement.—Prior to any subsequent disbursement to Borrower on account of the Loan, Bank shall receive (a) evidence satisfactory to Bank that there has been no adverse change since the date of the latest previous disbursement on account of the Loan in the financial condition, organization, operations, business prospects, fixed properties or personnel of Borrower sufficiently serious in the opinion of Bank to warrant withholding further disbursement on account of the Loan, or that any such adverse change in Borrower's financial condition has been remedied to the satisfaction of Bank in one or more of the methods specified in paragraph 8 (d) hereof, and (b) the instruments of hypothecation, agreements, documents, and evidence (if any) required by the Authorization as a condition to such disbursement; and (c) insurance policies (if additional collateral is required for such disbursement) and opinion of Bank's counsel with respect to such disbursement, in accordance with the provisions of paragraphs 8 (b) and 8(c) hereof, to the extent that said provisions are applicable to the disbursement then being made.

10. Advice to SBA.—Immediately upon making each disbursement to Borrower on account of the Loan, Bank will advise SBA in writing of the date and amount of such disbursement. Immediately upon receipt by Bank of any payment by Borrower of principal of or interest on the Loan, Bank will advise SBA in writing of the date and amount of each such payment. Upon the happening of any default by Borrower under the provisions of the Note or any other agreement in connection with the Loan, coming to the knowledge of Bank, Bank will within ten days thereafter forward appropriate notice thereof to SBA. Bank will at any time and from time to

time, forward to SBA such other information and advice in connection with the Loan as SBA may request. If and when requested by SBA, Bank will furnish SBA with a conformed copy of the Note, instruments of hypothecation and all other agreements and documents obtained by Bank in connection with the Loan.

11. Possession of Note and Collateral.—Banks shall, except as provided in paragraph 3 hereof, hold the Note, all the collateral therefor and all instruments delivered in connection therewith: Provided, however, That subsequent to the purchase by SBA of a participation in the Loan and upon written demand Bank shall five days after receipt of said demand transfer to SBA, without recourse, the Note, collateral, and instruments, all of which shall thereafter be held by SBA, and simultaneously therewith SBA shall issue to Bank a Certificate of Interest (on SBA Form 156*) evidencing the interest retained by Bank in the Loan.

12. Administration of Loan.—The holder of the Note shall receive all payments on account of principal of, or interest on, the Loan and promptly remit to the other party its pro rata share thereof determined according to their respective interests in the Loan, shall use due diligence to recover from Borrower all expenses properly incurred by SBA or Bank which are reimbursable by Borrower, and shall remit to the other party its respective share thereof: Provided, however, That such holder shall not (except to the extent permitted by the Authorization) without the prior written consent of the other party (a) make or consent to any alteration in the terms of the Note, collateral, or other instruments; (b) make or consent to any release, substitution, or exchange of any of said collateral; (c) accelerate the maturity of the Note; (d) sell, assign, or transfer any said collateral; (e) sue upon the Note, collateral, or instruments; or (f) waive any claim against Borrower or any guarantor, standby creditor or other obligor in connection with the Loan.

13. Payment of Expenses.—All reasonable expenses incurred by SBA or Bank which are not recoverable from Borrower shall be shared ratably by SBA and Bank in accordance with their respective interests in the Loan.

14. Liability and Representations.—Neither party hereto makes any express or implied warranty of any kind with respect to the Loan and neither party shall be liable to the other for any loss, not due to its own gross negligence, but such loss, shall be borne ratably by SBA and Bank in accordance with their respective interests in the Loan.

This Agreement shall inure to the benefit of and be binding upon the parties hereto and their respective successors and assigns.

In Witness Whereof, Bank has caused this Agreement to be executed on its behalf by its duly authorized officer or officers and its corporate seal to be hereunto affixed, and Small Business Administration has caused this Agreement to be executed on its behalf by its Regional Director of its Kansas City, Missouri, Regional Office, the day and year first above written.

BROOKVILLE STATE BANK

By

[Seal]

Attest:

SMALL BUSINESS ADMINISTRATION

By

(Title) *Regional Director*

Exhibit B to Proof of Claim

Note (For Limited Loan Participation Only) LLP-261, 398-KC Salina, Kansas (City and State) $20,000.00 (Date) November 16, 1956.

For value received, S. H. Byquist, d/b/a Western Distributors (hereinafter called "Undersigned"), promises to pay to the order of Brookville State Bank (hereinafter called "Holder"), at its banking house in the city of Brookville, State of Kansas, or at Holder's option, at such other place as may be designated from time to time by the Holder, the sum of Twenty Thousand and no/100- - - dollars, (Write out amount) with interest

on the unpaid principal computed from the date of each advance to the Undersigned at the rate of six percent per annum, payment to be made in installments as follows:

Monthly installments, each in the amount of $624.00; said monthly installments beginning two (2) months from the date hereof; each said monthly installment shall be applied first to interest accrued to the date of receipt thereof and balance to principal of the indebtedness; balance of principal and interest, if any, payable three (3) years from the date hereof.

Payment of any installment of principal or interest owing on this Note may be made prior to the maturity date thereof without penalty.

Affirmative Covenants.—The Undersigned covenants and agrees that, until the payment in full of the moneys owing on this Note, the Undersigned will:

1. Deliver to Holder hereof within 20 days after the end of each fiscal semiannual period, a balance sheet of the Undersigned as of such date and a profit and loss statement of the Undersigned for such fiscal period, certified by an accountant satisfactory to the Holder hereof;

2. Deliver to Holder hereof with reasonable promptness such other financial data at such times and in such form as Holder may request;

3. Pay all taxes, assessments and other governmental charges to which the Undersigned, or the property of the Undersigned, is or shall be subject before such charges become delinquent, except that no such charge need be paid so long as its validity or amount shall be contested in good faith by appropriate proceedings and the Undersigned shall have set up on the books of the Undersigned such reserve with respect thereto as shall be required by sound accounting practices;

12 4. Keep all of the real and tangible personal property of the Undersigned insured in such amounts and against such risks as may be satisfactory to the Holder or as are commonly insured against in the same areas by owners of similar property, and maintain in force policies of insurance, satisfactory to Holder, against liability for damage to persons or property and under all applicable workmen's compensation laws.

5. Use the proceeds of the loan solely for the purposes set forth in the Authorization for the Loan issued by Small Business Administration (hereinafter called "SBA").

6. On demand, reimburse Holder and SBA, respectively, for any and all expenses incurred, or which may be hereafter incurred by Holder or SBA from time to time in connection with or by reason of borrower's application for, and the making and administration of, the loan.

Negative Covenants.—The Undersigned covenants and agrees that, without the prior written consent of the Holder hereof, he will not:

1. Create, assume or otherwise suffer to exist any mortgage, pledge or other incumbrance upon any of the real or tangible personal property of the Undersigned, whether now owned or hereafter acquired, except (a) liens for taxes or other governmental charges not delinquent or being contested in good faith, or (b) purchase money liens upon property acquired after the date of the Note, and other liens upon such property at the time of the acquisition thereof.

2. Undersigned will not, without the prior written consent of Holder and SBA (a) if Undersigned is a corporation, declare or pay any dividend or make any distribution upon its capital stock, or purchase or retire any of its capital stock, or consolidate or merge with any other company, or make any advance, directly or indirectly, by way of loan, gift, bonus, commission, or otherwise, to any company directly or indirectly controlling or affiliated with or controlled by Undersigned, or to any officer, director, or employee of, Undersigned, or of any such company, (b) if Undersigned is a partnership or individual, make any distribution of assets of the business of Undersigned, other than reasonable compensation for services, or
13 make any advance, directly or indirectly, by way of loan, gift, bonus, commission, or otherwise, to any partner or any of its employees, or to any company directly or indirectly controlling or affiliated with or controlled by Undersigned.

Events of Default.—The indebtedness shall immediately become due and payable, without notice or demand, upon

the appointment of a receiver or liquidator, whether voluntary or involuntary, for the Undersigned or for any of its property, or upon the filing of a petition by or against the Undersigned under the provisions of any State insolvency law or under the provisions of the Bankruptcy Act of 1898, as amended, or upon the making by the Undersigned of an assignment for the benefit of its creditors. Holder is authorized to declare all or any part of the indebtedness immediately due and payable upon the happening of any of the following events: (1) Failure to pay any part of the indebtedness when due; (2) nonperformance by the Undersigned of any agreement with, or any condition imposed by Holder or SBA, or either of them, with respect to the indebtedness; (3) Holder's discovery of the Undersigned's failure in any application of the Undersigned to Holder or SBA to disclose any fact deemed by Holder to be material or of the making therein or in any of the said agreements, or in any affidavit or other documents submitted in connection with said application or the indebtedness, or of any misrepresentation by, on behalf of, or for the benefit of the Undersigned; (4) the reorganization (other than a reorganization pursuant to any of the provisions of the Bankruptcy Act of 1898, as amended) or merger or consolidation of the Undersigned (or the making of any agreement therefor) without the prior written consent of Holder; (5) the Undersigned's failure duly to account, to Holder's satisfaction, at such time or times as Holder may require, for any of the collateral, or proceeds thereof, coming into the control of the Undersigned; or (6) the institution of any suit affecting the Undersigned deemed by Holder to affect adversely its interest hereunder in the collateral or otherwise. Holder's failure to exercise any of its rights under this paragraph shall not constitute a waiver thereof.

Upon nonpayment of interest or any installment of principal when due, the Undersigned and sureties authorize the Holder to sell, at public or private sale, any or all collateral deposited and property pledged to secure the payment of this Note, and apply the proceeds of sale, less expense, to the payment of this Note.

14 The security rights of Holder and its assigns hereunder shall not be impaired by any indulgence, re-

newal, extension, or modification which Holder may grant with respect to the indebtedness or any part thereof, or in respect to the collateral or in respect to any endorser, guarantor, or surety without notice or consent of the Undersigned or any endorser, guarantor or surety.

S. H. Byquist, Individually and
d/b/a Western Distributors

I/We hereby guarantee payment of this Note:

Wife

We hereby assign this one certain note to The Small Business Administration without recourse.

The Brookville State Bank

By *Cashier*

IN UNITED STATES DISTRICT COURT

Stipulation Re Exhibits

Comes now John Q. Royce, attorney for the Trustee herein, and William C. Farmer, United States Attorney for the District of Kansas, and stipulate and agree that the following documents may be admitted in evidence in this case as Government exhibits, and marked as follows:

"Government Exhibit A"—Participation Agreement by the Brookville State Bank and SBA.

"Government Exhibit B"—Note on SBA Form 326 signed by the bankrupt.

"Government Exhibit C"—Certified copy of Treasury Check in the amount of $15,000.00.

"Government Exhibit D"—Application for a loan to SBA signed by bankrupt.

"Government Exhibit E"—Authorization for loan signed by SBA.

"Government Exhibit F"—Written demand for SBA purchase of 75% participation in the loan signed by Brookville State Bank.

15 "Government Exhibit G"—Letter from SBA to Bank enclosing Treasury Check for $15,000.00.

"Government Exhibit H"—Letter from SBA to bankrupt advising approval of the loan in the amount of $20,000.00 by SBA.

It is further stipulated and agreed that the Government offers in evidence herein the document marked "Government Exhibit I", an inventory of furniture as of August 7, 1957, signed by S. H. Byquist, and written on the letterhead of "Western Distributors", and the Trustee stipulates and agrees that said document is a full, true and correct copy of the original executed on or about the date it bears and was signed by S. H. Byquist, the bankrupt, and no objection is made by reason of the fact that a copy is offered instead of the original document. The Trustee does object to "Government Exhibit I" for the reason that there are statements thereon which are or may be construed to be opinions and conclusions of the said S. H. Byquist which are not binding on the parties hereto and are expressions of a legal conclusion and invade the province of the Court in this matter; that it is incompetent, irrelevant, immaterial and does not prove, or tend to prove, any matter in issue in this action.

JOHN Q. ROYCE
Attorney for Trustee

WILLIAM C. FARMER
United States Attorney
Attorney for Small Business Administration

[Government's Exhibit A to the stipulation is a participation agreement of November 19, 1956, and is identical with the participation agreement appearing as Exhibit A to the proof of claim reproduced at page 5.]

[Note November 16, 1956, for $20,000 of S. H. Byquist payable to the Brookville State Bank is not reproduced here since it appears as Exhibit B to the proof of claim appearing at page 10.]

16 **Government's Exhibit C**

Kansas City, Mo. 2-1 36,919,351 Treasury Division of Disbursement 10 Treasurer of the United States Through Federal Reserve Bank of Kansas City 18-4 000 Nov. 23 1956

[Seal] Thesaur. Amer. Septent. Sigil.

Pay $*15,000 Dollars 00 cts $*15,000.00*

To the Order of Brookville State Bank Brookville Kans LLP-261,398-KC

Drawn for above object

L. N. Looker
254 Regional Disbursing Officer
410

Do not fold, spindle or mutilate Know Your Endorser Require Identification

Identification Procedure

When cashing this check for the individual payee, you should require full identification and endorsement in your presence, as claims against endorsers may otherwise result.

The payee should endorse below in ink or indelible pencil.

If the endorsement is made by mark (X) it must be witnessed by two persons who can write, giving their places of residence in full.

It is suggested that this check be promptly negotiated.

Pay any Bank, Banker, or Trust Co. or order Previous endorsements guaranteed The Brookville State Bank (illegible) Brookville, Kans. 83-756

(illegible) 69 Bank & Trust Co. Nov. 27 56

17 Buy and Hold U. S. Savings Bonds Safe as America

[Clerk's Note: Endorsements appear on reverse side]

Government's Exhibit D

[Seal] Small Business Administration 1953

United States of America Small Business Administration Limited Loan Participation Application for Loan

This form is to be used only in applying for a loan in which the bank will participate to the extent of at least

25 percent and in which the Small Business Administration's share will be no more than $15,000 or 75% of the total amount of the loan, whichever is the lesser. The maximum maturity on Limited Loan Participation is 5 years and interest shall be no higher than 6 percent per annum.

(For instructions see page 4) LLP-261,398-KC

1. Name and address of applicant (Street, city, zone, and State) S. H. Byquist d/b/a Western Distributors 227 N. Santa Fe Salina, Kansas Received Oct 31 1956 SBA Kansas City Date of application October 8, 1956 Amount of loan requested $20,000.00 Maturity requested 3 years Date established 4-15-48 Number of employees (Including subsidiaries and affiliates) 7 Type of Business (Attach history of business on separate sheet) Wholesale Distributor of Radio & Electronic Supplies

2. Amount and Purposes of Loan (Give a brief general statement of need for proposed loan, including in the table below the specific purposes for which proceeds will be used):

General Statement Working Capital. For the purpose of discount on new purchases and accrued accounts payable, and to improve the cost ratio of merchandise purchases.

Purposes (List) As above. Amount $ Total (This should agree with amount of loan requested) $20,000.00

18 3. Proposed method for repayment of loan (State sources of funds and proposed schedule of repayment): Monthly, from business income.

4. Collateral offered (Attach list and description):

5. Names of Attorneys, Accountants, and other Parties. The names of all attorneys, accountants, appraisers, agents, and all other parties (whether individuals, partnerships, association or corporations) engaged by or on behalf of the applicant (whether on a salary, retainer or fee basis and regardless of the amount of compensation) for the purpose of rendering professional or other services of

any nature whatever to applicant, in connection with the preparation or presentation of this application or with any loan to applicant which SBA may make, or in which SBA may participate, as a result of this application, or such loan or participation; and all fees or other charges or compensation paid or to be paid therefor or for any purpose in connection with this application whether in money or other property of any kind whatever, by or for the account of the applicant, together with a description of such services rendered or to be rendered, are as follows:

Name and Address Clark, Mize & Lillard Salina, Kansas Description of Services Rendered and to be Rendered Legal Counsel as needed. Total Compensation Agreed to be Paid None Compensation Already Paid None

6. Financial Statement as of August 31, 1956. Fiscal Year ends December 31, 1956

(Statement must be dated within 60 days of the filing of this application. Omit $.00)

(The applicant may submit in lieu of the financial statement prescribed below, a copy of his regularly prepared financial statement dated within 60 days of the filing of this application provided he also supplies the supplementary detail called for on items marked with an asterisk)

19 Assets		
Cash on hand and in banks		$ 428.63
*Notes Receivable		
*Accounts Receivable	$	
Less Reserve for Doubtful Accounts		37,117.21
Inventories (How valued)		
*Finished	65,623.46	
Stock in Process		
Raw Material		65,623.46
*Other Current Assets		
Total Current Assets		$103,169.30
*Due from Affiliates or Subsidiaries		
*Due from Officers, Directors, and Stockholders		
Life Insurance (CSV)		
Land		
Buildings	$	
Machinery and Equipment		
Furniture and Fixtures	4,028.15	
Autos and Trucks	7,018.39	
Less Reserve for Depreciation	5,612.91	5,433.63
*Other Assets		5,450.00
Total Assets		$114,052.93

Liabilities	
*Notes Payable Other	$ 407.10
*Notes Payable to Banks	10,712.50
*Notes to Officers, Directors, and Stockholders	
*Notes to Others	
Accounts Payable for Merchandise	41,394.70
*Accounts Pay. Other	912.40
Income Taxes	
Other Accruals Taxes	458.02
*Other Current Liabilities	
Total Current Liabilities	$
*Mortgage Debts	
*Other Liabilities	
Total Liabilities	$
Capital Stock	$
Surplus and Undivided Profits	
Capital Account (If individual or partnership)	60,168.21
Total Liabilities and Net Worth	$114,052.93

20 * Itemize on a separate sheet all items marked with an asterisk. If any of the liabilities shown in the above financial statement are secured, state the amount and to whom owed and itemize collateral pledged as security.

Contingent Liabilities: Accounts or notes receivable discounted or sold with endorsement or guarantee and all other contingent liabilities, including terms of any leases, should be explained on a separate sheet. Also, describe any pending or imminent litigation.

Note.—Submit copy of last available audit or of financial statement at close of last fiscal period (if such date differs from date of above statement).

7. Comparative Statements of Sales, Profit or Loss, etc.

	"12-31-54	"12-31-55	"8-31-56 To Date
If a corporation, use this block:			
Net Sales (Gross sales less returns and allowances)	$	$	$
Net Profit (After depreciation and taxes)			
Depreciation			
Income Taxes			
Compensation of Officers (Included in expenses)			
Dividends Paid			
If a partnership or proprietorship, use this block:			
Net Sales (Gross sales less returns and allowances)	194,591.94	147,365.27	97,273.84
Net Profit (After depreciation	8,666.24	4,471.02	2,208.30
Depreciation	1,444.50	2,065.31	
Withdrawals (For income taxes)	3,314.52	1,486.54	400.00
Withdrawals (For other purposes)	5,477.00	5,924.74	4,635.55

21	Net Worth Reconciliation		
Net Worth-Beginning	70,477.60	70,352.32	67,412.06
Profit or Loss	8,666.24	4,471.02	2,208.30
Dividends Withdrawals	8,791.52	7,411.28	5,035.55
Net Change (Increase or decrease)			
Ending Net Worth	70,352.32	67,412.06	60,168.21
			16-72498-1

Notes Payable (Others):	Mason Investment Co.	$107.10
	Albert Bosch	300.00
		$407.10
Notes Payable (Banks):	Brookville S/B	$ 1,312.50
	Nat'l. Bk. of Am.	8,000.00
	Planters S/B	1,400.00
		$10,712.50
Accounts Pay. (Others):	Albert Bosch	$912.40
Accounts Receivable:	Attached	
Other Assets:	Personal Real Estate	$ 4, (illegible)
	Personal Cash on Hand	1, (illegible)
		$ 5,450.00

SBA Form 6a
(6-56)

Small Business Administration Credit Report (For Use of Small Business Administration only)

Furnished in connection with application of S. H. Byquist d/b/a Western Distributors (Name) 227 North Santa Fe (Address) Salina (City) Kansas (State)

In support of this participation loan, there is presented below our opinion as to the applicant and the loan requested (additional sheets may be used):

1. Need for Loan: (Are the requested funds available from assets of applicant or any of its owners or officers?) Working Capital—no other available loan

22 2. Comments on Management, its Experience, Character, and Ability: Several successful years Character good

3. Future Business Prospects and Ability to Repay: We feel the additional money applied for in this loan application will enable him to make enough additional funds to repay the loan as agreed.

4. Adequacy of Collateral (including appraised value): We feel that the inventory figure given in his financial statement is correct as to his inventory.

5. Bank's Previous Credit Experience with Applicant (attach a Commerical Credit Report on applicant, if available): Our previous experience has been very satisfactory. No commercial report available.

6. Have you any knowledge of any traits of character or personal behavior of the applicant or any of its partners, officers, or stockholders which you consider unsatisfactory in any respect? (If "Yes," detail on separate sheet.) No.

7. General Comments: We feel that the applicant is entitled to additional help and should be granted the loan.

The above information is furnished to the Small Business Administration only and solely for the purpose of determining whether or not credit should be extended to this applicant.

BROOKVILLE STATE BANK, BROOKVILLE, KANSAS
(Name and address of bank)

GLENN MASON
(Authorized officer)

Glenn Mason, President

Date October 30, 1956. (illegible 911023

SBA Form 6a
(6-56)

Small Business Administration Credit Report (For Use of Small Business Administration only)

23 Furnished in connection with application of S. H. Byquist, d/b/a Western Distributors (Name) 227 N. Santa Fe (Address) Salina, (City) Kansas (State)

In support of this participation loan, there is presented below our opinion as to the applicant and the loan requested (additional sheets may be used):

1. Need for Loan: (Are the requested funds available from assets of applicant or any of its owners or officers?) For working capital and funds to discount bills.

2. Comments on Management, its Experience, Character, and Ability: We have found Mr. Byquist to be a man of good reputation and integrity, as well as capable and industrious. He has operated this business for over seven years in Salina.

3. Future Business Prospects and Ability to Repay: We are of the opinion that his business prospects will improve, since the recent rains and that he will be able to take care of his obligations in a satisfactory manner.

4. Adequacy of Collerateral (including appraised value): We understand you are loaning on an unsecured note. He carries a large stock of new and saleable merchandise.

5. Bank's Previous Credit Experience with Applicant (attach a Commercial Credit Report on applicant, if available): Our credit experience has been satisfactory. We have loaned Mr. Byquist on several occasions and he has paid as agreed.

6. Have you any knowledge of any traits of character or personal behavior of the applicant or any of its partners, officers, or stockholders which you consider unsatisfactory in any respect? (If "Yes," detail on separate sheet.) No.

7. General Comments: Mr. Byquist carries his main account at the National Bank of America, Salina, Kansas. He also has an account with us and has borrowed on several occasions. We believe it is our opinion that he is worthy of any reasonable amount of credit. He bears a good reputation and enjoys a nice business.

24 The above information is furnished to the Small Business Administration only and solely for the pur-

pose of determining whether or not credit should be extended to this applicant.

Extra Credit Report
THE PLANTERS STATE BANK,
Salina, Kansas.
(Name and address of bank)
(illegible) President
(Authorized officer)

Date October 16, 1956.

GPO 911023

8. Information to be furnished as to each officer, partner or proprietor of applicant.

Name S. H. Byquist Date of Birth Jan. 31, 1904 Place of Birth Bloomington, Illinois U. S. Citizen? Yes.

Agreement on nonemployment of SBA personnel. In consideration of the making by SBA to applicant of all or any part of the loan applied for in this application, applicant hereby agrees with SBA that applicant will not, for a period of two years after disbursement by SBA to applicant of said loan, or any part thereof, employ or tender any office or employment to, or retain for professional services, any person who, on the date of such disbursement, or within one year prior to said date, (a) shall have served as an officer, attorney, agent, or employee of SBA and (b) as such, shall have occupied a position or engaged in activities which SBA shall have determined, or may determine, involve discretion with respect to the granting of assistance under the Small Business Act of 1953, or said Act as it may be amended from time to time.

Certification. I hereby certify that:

(a) To the best of my knowledge and belief, neither I nor any officer or partner of the applicant is now or ever has been a member of any organization, party, association, movement, group, or combination of persons which advocates the overthrow or destruction of the Government of the United States, or of any organization, party, association, movement, group, or combination of persons which has adopted a policy advocating, approving, or encouraging commission of acts of force or violence to

bring about the overthrow or destruction of the Constitution of the Government of the United States of America (any reservation, qualifications or exceptions to this certification are set forth by affidavit attached hereto).

(b) To the best of my knowledge and belief, neither I, nor any officer or partner of the Applicant has ever been arrested, charged, held or convicted by any Federal, State or other law enforcement authority for any violation of Federal, State (including U. S. territories and possessions), county or municipal law, regulation or ordinance, excluding traffic violations (any reservation, qualifications, or exceptions to this certification are set forth by affidavit attached hereto).

(c) The applicant has not paid or incurred any obligation to pay, directly or indirectly, any fee or other compensation for obtaining the loan hereby applied for, and has not paid or will not make any payment for services in connection with this application, without the consent of the Small Business Administration.

All information contained above and in exhibits attached hereto are true and complete to the best knowledge and belief of the applicant and are submitted for the purpose of inducing SBA to grant a loan, or to participate in a loan by a bank or other lending institution, to applicant. Whether or not the loan herein applied for is approved, applicant agrees to pay or reimburse SBA for the cost of any surveys, title or mortgage examinations, appraisals, etc., performed by non-SBA personnel with consent of applicant.

——— Proprietorship
(Individual, general partner, trade name or corporation)

[Seal]

By S. H. Bygust

Attest

(Title) Title Proprietor

26 Whoever makes any statement knowing it to be false, or whoever willfully overvalues any security, for the purpose of obtaining for himself or for any applicant any loan, or extension thereof by renewal, deferment

of action, or otherwise, or the acceptance, release, or substitution of security therefor, or for the purpose of influencing in any way the action of the SBA, or for the purpose of obtaining money, property, or anything of value, under the Small Business Act of 1953, as amended, shall be punished by a fine of not more than $5,000 or by imprisonment for not more than two years, or both.

(For use only by bank or other financial institution)

Application for Participation Agreement. We propose to make a (check one): Deferred participation loan X Immediate participation loan with bank to make and service to the Applicant named on page 1 of this application, provided SBA will participate in the loan to the extent of 75 percent. We hereby make application for the type of participation agreement checked above subject to the following loan conditions (use separate sheet if necessary):

Interest to be payable monthly at the annual rate of 6 percent on the loan.

Without the participation of SBA to the extent applied for we would not be willing to make this loan. In our opinion, the financial assistance applied for is not otherwise available on reasonable terms.

BROOKVILLE STATE BANK
(Name and address of bank)
Brookville, Kansas

GLEN: MASON
(Authorized officer)
President

Date October 30, 1956

Government's Exhibit E

United States Government Small Business Administration Kansas City Regional Office 911 Walnut Street Kansas City 6, Missouri Immediate Participation

27 Authorization

This Administration is authorized (pursuant to Section 207(a) of the Small Business Act of 1953, as amended)

to enter into a Participation Agreement on SBA Form 136 with Brookville State Bank, Brookville, Kansas, (hereinafter called "Bank"), for the purchase from Bank through the Regional Office of this Administration at Kansas City, Missouri, of an immediate participation of 75% of the Loan to be made by Bank to S. H. Byquist, D/B/A Western Distributors, Salina, Kansas, (hereinafter called "Borrower"), on Borrower's Application dated October 8, 1956, and Bank's Application dated October 30, 1956, Docket No. LLP-261,398-KC. The Participation Agreement is to be executed in behalf of this Administration by the Regional Director of said Regional Office, and the Loan is to be in the amount and disbursed subject to the conditions (in addition to the conditions set forth in the Participation Agreement and the written instructions, if any, of Regional Director to Bank) as follows:

1. Amount: Twenty Thousand Dollars ($20,000.00).

2. Note Payable:

Three (3) years from date of Note, with interest at the rate of six per cent (6%) per annum, and installments, including principal and interest, each in the amount of $624.00, payable monthly, beginning two (2) months from date of Note, and the balance of principal and interest payable three (3) years from date of Note; with the further provision that each said installment shall be applied first to interest accrued to the date of receipt of said installment, and the balance, if any, to principal.

3. Collateral:

First Mortgage of all equipment (excluding automotive equipment), fixtures and furniture now owned and hereafter acquired by Borrower (including, but not limited to (i) the equipment (excluding automotive equipment), fixtures and furniture referred to in Applicant's Financial Statement and stated therein to have a total book value of $4,028.00 as of August 31, 1956).

28 4. Use of Proceeds of Loan:

$20,000.00 solely for operating expenses of Borrower.

5. Total annual withdrawals of Borrower from his said business to be limited to $4,000.00 plus such additional amounts as may be necessary to pay income taxes on the profits of said business.

6. Note and all instruments of hypothecation to be executed by Applicant and wife.

7. Prior to each disbursement on account of the Loan, Bank shall be in receipt of evidence satisfactory to it in its sole discretion, that there has been no Adverse Change since the date of the Application, or since any of the preceding disbursements, in the financial or any other condition of Borower, which would warrant withholding or not making any such disbursement or any further disbursement.

8. Such other conditions not inconsistent with the provisions of this Authorization or of the Participation Agreement as may be imposed by Bank and Regional Director.

9. Disbursement of the Loan shall be made in the discretion of Bank in accordance with the provisions of this Authorization and the Participation Agreement, provided that no disbursement shall be made after a date four months from the date hereof.

The foregoing Authorization is issued pursuant to the approval of the Loan Application by the Small Business Administration on November 2, 1956.

WENDELL M. BARNES, *Administrator*

By WALLACE M. BUCK
Acting Regional Director
Small Business Administration

Regional Director's Action No. 2323

29 **Government's Exhibit F**

Small Business Administration 911 Walnut Street Kansas City 6, Missouri Date: November 16 1956

Re: LLP-261,398-KC S. H. Byquist, d/b a Western Distributors Salina, Kansas

Gentlemen: We are ready to make full disbursement in the amount of $20,000.00 on account of the subject loan and submit herewith our written demand on SBA Form 191 for your purchase of your agreed participation of 75% of such disbursement, pursuant to the provisions of paragraph 2 of our Participation Agreement with you on SBA Form 136 dated November 16, 1956.

In our opinion, our bank has complied with all of the conditions of the Participation Agreement and of the Authorization of Small Business Administration approved November 2, 1956 in connection with the subject loan, which are required to be fulfilled prior to first disbursement to the Borower on account of the loan.

Yours very truly,

BROOKVILLE STATE BANK
Brookville, Kansas
By R. D. POWER
Cashier

Government's Exhibit G

Small Business Administration Federal Office Building 911 Walnut Street Kansas City 6, Missouri November 21, 1956

Brookville State Bank, Brookville, Kansas Attention: Glenn Mason, President Re: LLP-261, 398-KC S. H. Byquist, a/b a Western Distributors Salina, Kansas

Gentlemen: Reference is made to your letter dated November 16, 1956 submitting for our examination
30 and review copies of the closing documents for our files in connection with the subject loan.

Examination of the instruments indicates that they are properly drawn and in order. We are returning herewith

the original Participation Agreement for bank's files, which has been dated and signed by the Regional Director.

Predicated on your certification and written demand made upon Small Business Administration under the provisions of Paragraph 2 of the Participation Agreement dated November 19, 1956, there is enclosed for purchase of this Administration's agreed participation in the full disbursement which you will make on account of the loan.

United States Treasury Check No. 36,919,351 dated November 23, 1956, payable to the order of your bank in the sum of $15,000.00.

This check is to be accepted and negotiated by your bank only under the following conditions:

1. That the amount disbursed on account of the loan is the entire amount of the loan, $20,000.00.

2. That the proceeds of the check will be used solely for the purchase by Small Business Administration of its agreed participation of 75 per cent of the amount disbursed by your bank on account of the loan.

3. That your bank will concurrently with the acceptance of this check execute and deliver to Small Business

Administration a Participation Certificate on SBA Form 152 evidencing the interest of Small Business Administration in the loan so purchased.

The Participation Certificate (SBA Form 152) is enclosed, in duplicate, to be completed by you to show the date of the disbursement, then dated at the bottom of the Certificate (not earlier than the date of the disbursement) and executed by an authorized official of your bank, thereafter the original to be returned to this office. Retain the copy for bank's files.

31 SBA Form 172 is used when the bank reports its monthly repayments and remits therefor to Small Business Administration in payment of its proportionate share of such repayment. Submit in duplicate and be careful that the form is fully complete as to dates, etc. A supply of these forms is enclosed for your use.

Please acknowledge receipt of the enclosed check on the

carbon copy of this letter attached. This is necessary in order for us to determine the purchase of our participation.

Sincerely yours,

WALLACE M. BUCK, *Chief*
Financial Assistance Division

Receipt is hereby acknowledged of United States Treasury Check No. 36919351 dated November 23, 1956, payable to the Brookville State Bank, Brookville, Brookville, Kansas, in the amount of $15,060.00, this 23 day of November 1956.

BROOKVILLE STATE BANK
By R. D. BOWER
Cashier

Government's Exhibit H

Baltimore 1-700 Ext 8-767 November 2, 1956

Mr. S. H. Byquist, d b a Western Distributors 227 N. Santa Fe Salina, Kansas Re: LLF-261398-KC

Dear Mr. Byquist: This will advise you that Small Business Administration today approved your application for an immediate participation loan in the amount of $20,000.

The approval is subject to terms and conditions which will be included in a Loan Authorization to be issued by this office and forwarded to you at a later date.

Sincerely yours,

C. I. MOYER
Regional Director

CC Brookville State Bank, Brookville, Kansas
2 cc Fiscal

Western Distributors Wholesale Distributors of Radio and Electronic Supplies Home Office - Salina, Kansas

Stan Byquist

Page 1 Inventory of Furniture as of August 7, 1957

7 Moore ticket machines 1 Office radio National Union 1 Office clock Sylvania 2 Four drawer metal boxes 1 Small safe 1 Wooden Adjustable office chair 2 Four shelf Gray steel storage cabinet 1 Wooden card file 2 Metal card file 1 Wood file cabinet 4 drawer green 2 Wire invoice baskets 1 Gray pencil sharpener 1 Permical tape machine 1 Pitney Bowes postage machine 1 postage scale 1 Cameo 5 ton air conditioner 1 Wooden 6 drawer desk 1 Wooden chair with arms 1 Wooden chair with arms and rollers 1 Gray metal table 2 metal waste baskets 1 Metal *dest* 5 drawers 1 Invoice rack 3 shelves 2 Metal four drawer file 1 desk lamp 1 Underwood Sundstrand Adding Machine 932459 1 Masco WF2 Intercom 2 Metal typewriter stands 1 Large Double wood desk 1 *Exective* Metal Chair 1 Swingline stapler 2 Two door storage cabinets 1 Dalton Adding Machine 1 Underwood Typewriter 1 Underwood upright Typewriter 1 *Exective* chair with arms and rollers 1 Bostish stapler 1 Leather covered lounge chair 1 5 drawer storage cabinet 1 four drawer file cabinet 1 Lounge chair leather covered 1 Gray metal five drawer desk 1 Metal cash box 4 wooden plastic covered stools 1 Metal table

The undersigned, S. H. Byquist, does hereby surrender and deliver unto The Brookville State Bank, Brookville, Kansas, and the Small Business Administration, an agency of the United States government, the foregoing tabulated office furniture and fixtures, it being understood that said bank and said agency are the owners and holders of a valid lien on said property. The undersigned hereby authorizes said bank and said agency to lease the use of said property unto G. M. McClellan, to be appointed liquidating agent for the said S. H. Byquist, under such terms and conditions deemed appropriate by said bank and said agency for a period of not to exceed nine months from date and that the net proceeds of such lease shall be applied to

33 the indebtedness of the undersigned unto said bank

and said agency, and that when and if said bank and said agency fail to lease said property, that they may proceed to sell the same without notice to the undersigned and apply the net proceeds from the sale thereof upon said debt. Dated at Salina, Kansas, this 7th day of August, 1957.

S. H. Byquist

IN UNITED STATES DISTRICT COURT

Memorandum in Support of Objection to the Claim of the United States of America

FACTS

There is no dispute as to the material facts involved in this claim.

On November 19, 1956, the Small Business Administration and the Brookville State Bank, Brookville, Kansas, entered into a Participation Agreement between themselves whereby it was agreed that the Bank would make a loan to the bankrupt in the amount of $20,000.00, in which SBA would participate. The Participation Agreement is attached to the Proof of Claim filed herein as Exhibit "A".

By the Participation Agreement, the Small Business Administration agreed that it would, through funds received from the United States Treasury, upon written demand by the Bank purchase from the Bank a participation of 75% of the amount of the loan, or the amount of $15,000.00. It was further agreed that any losses sustained as a result of this loan would be shared ratably between the Small Business Administration and the Brookville State Bank in accordance with the respective interests in the loan, or on a 75-25% basis.

On November 23, 1956, the Treasurer of the United States through the Federal Reserve Bank, Kansas City, Missouri, issued a check to the Brookville State Bank for $15,000.00, representing 75% of the loan; the Brookville
34 State Bank put up $5,000.00 and made a loan in the full amount of $20,000.00 to the bankrupt.

The loan was evidenced by a Promissory Note dated November 16, 1956, payable to the order of the Brookville

State Bank, Brookville, Kansas, in the face amount of $20,000.00, with interest at the rate of 6% per annum on the unpaid principal and requiring payment in monthly installments in the amount of $624.00; each monthly installment to be applied first to interest accrued to date of receipt thereof, and the balance to principal of the indebtedness; the entire principal balance and interest, if any, payable three years from the date of said note. Said note is attached to the Proof of Claim filed herein as Exhibit "B".

On September 5, 1957, the bankrupt was adjudicated in bankruptcy.

After bankruptcy proceeding was instituted, the Brookville State Bank assigned its interest in said loan to the Small Business Administration, who duly filed a Proof of Claim in bankruptcy for the full amount of the principal due both to it and to the Brookville State Bank.

As of November 22, 1957, after all due credits were given on the loan, there remained due to both the Brookville State Bank and the Small Business Administration the sum of $16,355.69; interest having been paid thereon only to the date of adjudication in bankruptcy.

There is now unpaid on said note to the Small Business Administration the sum of $12,266.77, and to the Brookville State Bank the sum of $4,088.92.

The total gross estate herein is approximately $19,527.00.

Claims have been filed herein totaling $43,682.07.

Costs of administration for this estate are estimated at approximately $6,500.00.

* * * * *

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35 IN UNITED STATES DISTRICT COURT

Brief in Support of Claim of United States of America—Filed June 26, 1958

Facts

In addition to the facts heretofore stipulated to between the Trustee and the United States, and which are set forth in the Trustee's brief, the United States also calls the Court's attention to Government Exhibits A through

I, which have been admitted in evidence by stipulation of the parties hereto.

* * * * *

Filed June 26, 1958 E. R. Sloan, Referee

IN UNITED STATES DISTRICT COURT

Memorandum Opinion of Referee on the Priority of Claim of Small Business Administration—June 26, 1958

At Topeka, Kansas, on May 21, 1958, this cause came on for hearing on the application of the trustee, asking the court to determine the priority status, if any, of Claim No. 49 of the Small Business Administration, the trustee appearing by his attorney, John Q. Royce, and the Small Business Administration appearing by the District Attorney.

It was agreed in open court that there were no disputed facts in the case, and that the case should be submitted on written briefs. The briefs have been filed and have received due consideration.

This case was commenced August 17, 1957 by the filing of an involuntary petition in bankruptcy. Thereafter, on the 5th day of September, 1957, the alleged bankrupt was adjudged a bankrupt. The first meeting of the creditors was held October 22, 1957, and G. M. McClellan was duly appointed trustee. The trustee has proceeded with the liquidation of the estate and has in his hands as a result thereof $19,016.03.

On October 15, 1957, George E. Depew, Acting Regional Director of the Small Business Administration, filed
36 a proof of claim in which he alleged that there is due and owing the Small Business Administration the sum of $16,788.42. It is alleged that the consideration for the claim is a promissory note in the amount of $20,000.00 given by the bankrupt to the Small Business Administration in accordance with a participation agreement entered into on November 19, 1956, between the Brookville State Bank and the bankrupt.

Under the terms of the participating agreement the Small Business Administration obligated itself to partici-

pate in the loan of $20,000.00 to the extent of 75% thereof, and on November 23, 1956, upon the check of the regional distributing office on the Treasurer of the United States, $15,000.00 was paid to the Brookville State Bank.

On November 22, 1957, after all due credits were given on the loan there remained due to both the Brookville State Bank and the Small Business Administration the sum of $16,355.69, with interest paid to the date of bankruptcy. That there is due and owing under the agreement and promissory note the Small Business Administration the sum of $12,266.77, and the Brookville State Bank the sum of $4,088.92.

The sole question to be determined is whether the Small Business Administration has a priority or an unsecured claim.

The distribution of an estate in bankruptcy is controlled by the Bankruptcy Act. Claims are generally classified secured (Sec. 1(28), priority (Sec. 24) and unsecured (Sec. 65). Priorities as defined in the Act include "(5) debts owing any person, including the United States, who by the laws of the United States is entitled to priority". Priorities are granted only to claims that come within the provisions of the Act. It is settled that the status of a claim against the bankrupt is fixed the date the petition is filed. (Sexton v. Ereyfus, 219 U.S. 399; U.S. v. Marxen, 307 U.S. 200; Goggin v. Labor Division, 336 U.S. 118)

Sec. 31 U.S.C. 191 which provides that in case of insolvency of any person indebted to the United States, the debt due to the United States shall be first satisfied does not apply in bankruptcy cases. (In re Taylor Pratt Aviation Corp., 168 F. 2d 808, and cases there cited) The Bankruptcy Act provides that debts owing to any
37 person, including the United States, who is entitled to a priority shall have a fifth priority in the order of payment. A debt due the United States is therefore entitled to a classification of a fifth priority. (Sec. 64a(5)) But no priority is given to wholly owned government corporation by 31 U.S.C. 191. (Sloan Shipyard Corporation v. United States Shipping Board, 258 U.S. 549) The United States doing business through a corporation does not extend its sovereign immunities or its priorities to such corporation unless specifically granted. (United States v.

Edgerton and Sons, 178 F. 2d 763; R.F.C. v. J. G. Menihan Corp., 312 U.S. 81; Harlingen Canning Co., v. C.C.C., 93 F. Supp. 45; United States v. Paddock, 187 F. 2d 271. Nathanson v. N.L.R.B., 344 U.S. 25)

This brings us to the question of the status of the Small Business Administration.

The Act bringing into being the Small Business Administration became effective July 30, 1953. It is now Title 15, U.S.C., 631 to 651 inclusive. It creates an agency under the name, "Small Business Administration," which administration shall be under the general direction and supervision of the President and shall not be affiliated with or be within any other agency or department of the federal government. The management of the Administration is vested in an administrator appointed by the President. He is authorized to obtain money from the Treasurer of the United States for use in the performance of the powers and duties granted to or imposed upon him by law, for which he must account with interest at the end of each fiscal year. He may enter into contracts, buy and sell property and sue and be sued in any court of record of a state having general jurisdiction or in any United States District Court.

It would appear that the granting of these various powers makes the Small Business Administration a legal entity. It seems to fit into what the Supreme Court said in R.F.C. v. Menihan Corp., supra, in which it said:

"While it acts as a governmental agency in performing its functions (see Pittman v. Home Owners' Loan Corp., 308 U.S. 21, 32, 33), still its transactions are akin to those of private enterprises and the mere fact that it is an agency of the government does not extend to it the immunity of the sovereign. . . ."

38 We have carefully examined the Act creating the "Small Business Administration" and we are unable to find and our attention has not been called to any provision in the Act purporting to give it a priority, or to vest it with privileges and immunities of the United States. The debt in question is owing to Small Business Administration for which it must account to the Treasurer of the United States. It is not given a priority under the laws of the United States.

We are, therefore, brought to the conclusion that the

claim of Small Business Administration is not entitled to a priority, but may be allowed only as an unsecured claim.

It Is So Ordered.

Dated this 26th day of June, 1958.

E. R. SLOAN
Referee in Bankruptcy

Filed June 26, 1958 E. R. Sloan, Referee

IN UNITED STATES DISTRICT COURT

Petition for Review of Order Denying Priority of Small Business Administration Claim—Filed June 30, 1958

Comes now William C. Farmer, United States Attorney for the District of Kansas, and files herewith a Petition for Review of the Order of the Referee dated June 26, 1958, denying priority to the claim of the Small Business Administration, the same being Claim No. 49, and respectfully represents to the Court that the United States feels that the Honorable E. R. Sloan, Referee in Bankruptcy herein, errored to the prejudice of this petitioner in his conclusion that the claim of the Small Business Administration is not entitled to priority but may be allowed only as an unsecured claim.

It is shown to the Court that there is no dispute as to the facts of this case. The bankruptcy case was commenced on August 17, 1957, and the bankrupt was adjudicated a bankrupt on September 5, 1957, with the first meeting
39 of creditors being held on October 22, 1957. The Small Business Administration timely filed a claim in the bankruptcy action alleging that there was due the Small Business Administration the sum of $16,788.42. This claim arose out of a loan which the Small Business Administration and the Brookville State Bank made to the bankrupt in the amount of $20,000.00 and in which the Small Business Administration had a Participation Agreement in which they participated in the loan to the extent of 75%. The Small Business Administration gave to the Brookville State Bank a Treasury Check in the amount of $15,000.00 as their proportionate share, and there was at the time of bankruptcy due the Small Business Admin-

istration the sum of $12,266.77 and the balance was due the Brookville State Bank. The sole question to be determined is whether the Small Business Administration is entitled to a priority or only an unsecured claim.

Wherefore, petitioner prays the Court to review the findings and conclusions of the Referee on the matters herein set forth, correcting the errors herein alleged, and that the Referee herein certify the said question to the Court for that purpose and that he send up with said Certificate the exhibits introduced by the Government and the Stipulation of the parties herein.

WILLIAM C. FARMER
United States Attorney
Attorney for the United States

Filed June 30, 1958.

IN UNITED STATES DISTRICT COURT

Certificate of Referee to Judge on Petition for Review—Filed June 30, 1958

The Referee in Bankruptcy for the District of Kansas hereby certifies that in the course of the proceedings in the above entitled case the question of the classification of the claim of the Small Business Administration came on for consideration.

The court held upon hearing that the claim should be classified as an unsecured claim.

40 Thereafter, and within the time given by the Referee, a petition for review was filed asking that the order be reviewed by the Judge.

Accompanying this certificate of the Referee are:

1. Petition for review.
2. Memorandum opinion, including findings and order.
3. Briefs of attorneys.
4. Stipulation as to facts.
5. Proof of claim No. 49.

Dated this 30th day of June, 1958.

E. R. SLOAN
Referee in Bankruptcy

Filed July 1 1958 Harry M. Washington, Clerk By Elizabeth C. Rion Deputy.

IN UNITED STATES DISTRICT COURT

Opinion--Filed Dec. 30, 1958

Stanley, Jr., Judge: The United States has petitioned for review of an order of the referee in bankruptcy denying priority to a claim of the Small Business Administration.

This case was commenced on August 17, 1957, by the filing of an involuntary petition in bankruptcy. Byquist was adjudged a bankrupt on September 5, 1957. On October 22, 1957, a trustee was duly appointed. The trustee has proceeded with the liquidation of the estate and has in his hands a sum in excess of $19,000.00.

On October 15, 1957, the claim here involved was filed. Omitting the caption and verification, it reads:

41 "1. That the claimant, the United States of America, is a corporate sovereign and body politic. That the Small Business Administration, whose principal officer is Wendell B. Barnes, Administrator, Small Business Administration, Washington, D. C., maintains its Ninth Regional Office at 911 Walnut Street, Kansas City 6, Missouri, and is a duly authorized agency of the United States of America at all times hereinafter mentioned.

"2. That deponent is the duly appointed, qualified and Acting Regional Director of Small Business Administration, an independent agency of the United States Government; that deponent is duly authorized under instrument of authority published in the Federal Register on April 18, 1956 (21 F.R. 2544), incorporating by reference that published August 13, 1954 (19 F.R. 5119), and that published July 17, 1954 (19 F.R. 4433), to make this proof of claim.

"3. That above-named bankrupt is fully and duly indebted to said Small Business Administration in the sum of Sixteen Thousand Seven Hundred and Eighty-Eight and 42/100 ($16,788.42) Dollars; said sum represents the total indebtedness due and payable by bankrupt by virtue of the failure to repay to Small Business Administration the indebtedness arising from the loan made by the Brookville State Bank, Brookville, Kansas, to said bankrupt; said sum consists of Sixteen Thousand Four Hundred Sixty-Two and 31/100 ($16,462.31) Dollars principal due, and

Three Hundred Twenty-Six and 11/100 ($326.11) Dollars as interest due to but not including October 16, 1957, and that thereafter the daily interest accrual on the principal is $2.7437.

"4. That the consideration of said indebtedness is as follows:

"(a) A Note in the principal amount of $20,000.00, duly executed and delivered to the said bank and thereafter assigned to the Small Business Administration pursuant to the Participation Agreement, attached as 'Exhibit A'. Attached hereto and made a part hereof and marked 'Exhibit B' is a photostatic copy of the above-mentioned Note.

"5. That the said S. H. Byquist has defaulted on the terms and conditions of the Note designated as
42 'Exhibit B' and that there is now due and owing the aforesaid sum by virtue of said default.

"6. This claim is filed as a Priority Claim.

UNITED STATES OF AMERICA, *Claimant*
By WENDELL B. BARNES, *Administrator*
Small Business Administration

By [s] GEORGE E. DEPEW
George E. Depew,
Acting Regional Director"

The facts are not disputed. The bankrupt had applied to the Brookville State Bank of Brookville, Kansas, for a loan in the amount of $20,000.00. After various conferences and examination of reports submitted to the Small Business Administration, a participation agreement was entered into between the bank and the Small Business Administration under the provisions of which the Small Business Administration agreed to participate to the extent of 75% of the loan. In compliance with the agreement, Small Business Administration paid over to the Brookville State Bank the sum of $15,000.00 by a draft drawn on the Treasurer of the United States. The bank then loaned the money to the bankrupt and a negotiable instrument was executed by the bankrupt solely to the bank for the full amount of the loan. The instrument did contain

certain conditions which referred to the Small Business Administration but there was nothing on the instrument to indicate that Small Business Administration was to be considered as a payee. Following the bankruptcy of the borrower, the bank assigned the note to the Small Business Administration. (The Government concedes that "the interest of the bank, which was 25% of the loan, was assigned to SBA subsequent to the date of bankruptcy.")

The distribution of an estate in bankruptcy is controlled by the Bankruptcy Act, 11 U.S.C.A. §§ 1-1255. Thus, it has been determined that the general provisions of 31 U.S.C.A. § 191 are not applicable in bankruptcy proceedings to permit any debts owing to the United States to be paid before any other debt. In re Taylorcraft Aviation Corporation, 168 F. 2d 808 (6 Cir. 1948). Section 104 of 11
43 U.S.C.A. (§ 64, Bankruptcy Act) provides that debts owing to the United States are to be given a priority if by the laws of the United States the debt would have been entitled to a priority. A debt due the United States of the class involved here would be classified as a fifth priority debt when a claim is made in bankruptcy proceedings. In re Weil, 39 F. Supp. 618 (M.D. Pa. 1941).

The referee in denying the priority to Small Business Administration based his decision upon the fact that priority is not granted to debts owing to a corporation even though the corporation be solely owned by the United States. Sloan Shipyards v. U. S. Fleet Corp., 258 U.S. 549 (1922); 66 L. Ed. 762; 42 S. Ct. 386; R. F. C. v. Menihan Corp., 312 U.S. 81 (1941); 85 L. Ed. 595; 61 S. Ct. 485. There is a distinction between the cited cases and the case in question—in the cited cases there was an actual corporation which was representing the federal government. This distinction has been recognized. Remington on Bankruptcy, Vol. 6 at page 459 states:

"A branch or agency of the federal government, not set up as a distinct corporation but only as an operative medium, such as an 'administration,' 'authority,' 'bureau,' 'commission,' or the like, though it may be invested with certain corporate powers such as the power to sue and be sued, is regarded as the government itself and, as such, entitled to the general priority accorded to debts due the government from an insolvent under 31 U.S.C.A. § 191."

Courts have also recognized the distinction between a corporate agency and an administration. In Korman v. Federal Housing Administrator, 113 F. 2d 743 (D.C. Cir. 1940), the court permitted the FHA to be given a priority. As to the provisions in the Code permitting the FHA to sue and be sued, the court stated that this did not operate to create a separate corporate entity but rather operated to remove the immunity of the sovereign to suit. The court rejected the argument that the provision for suit was sufficient to make the FHA a separate legal entity. For other court recognition of this distinction see: In re Miller, 105 F. 2d 926 (2nd Cir. 1939); In re Hansen Bakeries, 103 F. 2d 665 (3rd Cir. 1939); Wagner v. McDonald, 96 F. 2d 273 (8th Cir. 1938).

44 There is nothing in the act creating the Small Business Administration to indicate that it was to be a separate corporation. 15 U.S.C.A. §§ 631-651. The Administration is given certain powers which are generally possessed by corporate agencies or by separate legal entities. However, Wagner v. McDonald, supra, indicates that mere possession of these powers would not be considered sufficient to prevent the agency in question from being an "administrative" agency, as compared to a "corporate" agency.

In Nathanson v. Labor Board, 344 U.S. 25 (1952); 97 L. Ed. 23; 73 S. Ct. 80, where the court denied priority to the NLRB on its claim in bankruptcy proceedings, it could not be claimed that denial was not proper since no benefit would accrue to the United States if a priority were allowed. The NLRB had made an order requiring additional payments to be made to certain employees and the claim of the NLRB was based upon this order. There was no side contract requiring the NLRB to make the payments to the employees; all money received from the estate would have been distributed directly to the employees.

The referee believed that the powers which were granted to the Small Business Administration fell within the case of R.F.C. v. Menihan Corp., supra, where the court said at page 83: "While it acts as a governmental agency in performing its functions (see Pittman v. Home Owners' Loan Corp., 308 U.S. 21, 32, 33), still its transactions are akin to those of private enterprises and the mere fact that

it is an agency of the government does not extend to it the immunity of the sovereign . . .'' The force of this language is diminished when it is remembered that this statement was directed at a ''corporate'' agency of the government.

The purposes of the FHA and the Small Business Administration are quite similar in that both are designed to bolster the economy by providing funds for housing and business needs respectively. There are differences in the two administrations but there is nothing to indicate that Congress intended the Small Business Administration to be treated in a different manner from that accorded the FHA. Congress would have been cognizant of the problem of priority of claims presented by the federal agencies in bankruptcy proceedings and that the ''corporate'' agencies have been denied the priority. Yet there was nothing in the act to indicate that Congress intended it to be treated other than as an ''administrative'' agency which has been permitted priority. See Korman v. Federal Housing Administrator, supra.

45

However, whether or not the Small Business Administration is to be considered as a separate entity is not believed to be of controlling importance here. It appears that the debt due the Small Business Administration did not arise until after the adjudication in bankruptcy. The note executed by the bankrupt was made payable to the bank, the Small Business Administration paid over its money to the bank, the bank paid the total amount of the loan to the bankrupt, and all payments on the loan were to be made to the bank. The bank was the sole payee. By the very terms of its own form Small Business Administration was not made a party-lender. The only connection it had with the loan was by virtue of its agreement to participate which was made, not with the bankrupt so as to obligate him to the Small Business Administration, but with the bank. Until the assignment of the note by the bank to the Small Business Administration there was no means by which Small Business Administration could force the bankrupt to make any payments to it even in the event that the bank refused to carry through the agreement between the bank and Small Business Administration.

In the leading case of United States v. Marxen, 307 U.S.

200 (1939); 83 L. Ed. 1222; 59 S. Ct. 811, it is firmly established that the rights to or status of a claim against the bankrupt's estate is determined on the date the petition is filed and an assignment after that date gives the assignee no greater rights than the assignor possessed prior to the assignment." Kerman v. Federal Housing Administrator, supra. In the case at bar the Small Business Administration has conceded that the assignment of "the bank's interest" was made after the filing of the petition. There is nothing in the record to indicate that any separation of the loan had been made and the only assignment was of the entire note. The assignment is found on the note executed by the bankrupt to the bank and it does not purport to assign only the bank's interest but assigns "this one certain note."

46 The referee properly denied the Small Business Administration a priority on its claim since it is conceded that the assignment by the bank occurred subsequent to the filing of the petition.

The order of the referee is approved and affirmed for the reasons herein stated.

Counsel for the trustee will prepare and submit an appropriate order.

Filed December 30, 1958.

IN UNITED STATES DISTRICT COURT

Order Affirming Referee—June 28, 1959

Now on this 12th day of September, 1958, the above entitled matter comes on for hearing before the Court on the petition for review of the order of the referee dated June 26, 1958, denying priority to the claim of the Small Business Administration, the Trustee appearing by John Q. Royce, his attorney, and the petitioner appearing by Wilbur G. Leonard, United States Attorney, its attorney.

Thereupon, it is shown to the Court that there are no disputed facts in this matter, and the facts as stipulated by the parties before the Referee may be received by the Court as the facts herein.

Thereupon, the Court requests that briefs be filed with the Court by the respective parties.

Now on this 6th day of November, 1958, briefs having been duly filed by the parties hereto, the above entitled matter is assigned for oral argument, the respective parties appearing as before.

Thereupon, the parties make their arguments to the Court and the Court takes said matter under advisement.

And now on this 30th day of December, 1958, the Court having duly considered the evidence introduced herein, and the briefs and arguments of the parties hereto, and being duly advised in the premises finds that the priority claimed by the Small Business Administration should be denied, and the claim allowed only as an unsecured claim, and that the order of the Referee should be approved and affirmed for all of the reasons stated in the opinion of the Court this date filed herein.

47

Wherefore, It Is Considered And Ordered By The Court, That the claim of the Small Business Administration for priority be and it is hereby denied and said claim is allowed only as an unsecured claim, and that the order of the Referee be and it is hereby approved and affirmed.

Dated at Topeka, Kansas, this 28 day of January, 1959.

ARTHUR J. STANLEY, JR.
District Judge

Approved By:

JOHN Q. ROYCE

WILBUR G. LEONARD
United States Attorney

Filed January 28, 1959.

IN UNITED STATES DISTRICT COURT

Notice of Appeal—Filed Jan. 29, 1959

Notice is hereby given that the plaintiff, United States of America, hereby appeals to the United States Court of Appeals for the Tenth Circuit from the Order and Judgment of this Court entered herein on January 28, 1959,

pursuant to opinion of the Court rendered on December 30, 1958.

Dated this 29th day of January, 1959.

WILBUR G. LEONARD
United States Attorney
Attorney for Plaintiff

Filed Jan 29 1959 Harry M. Washington, Clerk By L. (illegible) Lutes Deputy.

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48 Clerk's Certificate to foregoing Transcript (omitted in printing)

IN THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

49 **Minute Entry of Argument and Submission of Case—Sept. 10, 1959**

(omitted in printing)

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50 IN THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

No. 6117—September Term, 1959

SMALL BUSINESS ADMINISTRATION, *Appellant*,

v.

G. M. McCLELLAN, Trustee, *Appellee*.

In the matter of S. H. BYQUIST, and individual, doing business as Western Distributors, Bankrupt.

Appeal from the United States District Court
for the District of Kansas

Opinion—November 6, 1959

Morton Hollander, Attorney, Department of Justice (George Cochran Doub, Assistant Attorney General, Wilbur G. Leonard, United States Attorney, and Samuel

D. Sladé and Peter H. Schiff, Attorneys, Department of Justice, were on the brief) for Appellant.

John Q. Royce for Appellee.

Before Bratton, Lewis and Breitenstein, Circuit Judges.

Breitenstein, Circuit Judge.

51 In this bankruptcy proceeding the court below affirmed a referee's order allowing a claim of Small Business Administration as an unsecured claim and denying it any priority. The only question on appeal is the right to priority over other unsecured creditors.

The facts are not in dispute. Byquist, the bankrupt, applied on a Small Business Administration[1] form, entitled "Limited Loan Participation Application for Loan," to the Brookville State Bank of Brookville, Kansas, for a $20,000 loan. On October 30, 1956, the Bank endorsed the application to show that it was willing to make the loan upon the participation of SBA therein to the extent of 75%. SBA agreed and on November 19, 1956, entered into a "Participation Agreement" with the Bank. Therein it was provided that upon written demand by the Bank SBA would purchase a 75% interest; that the Bank would hold the note and on five days written demand would transfer it to SBA; that the holder of the note would service it and remit promptly to the other party its pro rata share; and that SBA and the Bank were to bear any loss incurred ratably according to their respective interests in the loan.

52 On November 21, 1956, SBA sent the Bank its check in the amount of $15,000 for the sole purpose of purchasing a 75% interest in the loan. The Bank then loaned $20,000 to Byquist who executed and delivered a note payable to the Bank and made out an SBA form in which he agreed to use the loan proceeds solely for the purposes set out in the SBA loan authorization and to reimburse the "Holder" and SBA for expenses incurred by them in connection with the loan.

After the filing of an involuntary petition in bankruptcy, Byquist was adjudicated a bankrupt on September 5, 1957, and a trustee was duly appointed. The estate is valued

[1] Hereinafter referred to as SBA.

at approximately $19,000 and the claims filed exceed $43,000.

Subsequent to the date of bankruptcy, the Bank assigned the note to SBA which on October 15, 1957, filed a claim for the unpaid balance amounting to $16,788.42 and claimed priority therefor.

At the outset we have the contention of the trustee that SBA is not an agency of the United States and hence is not entitled to any priority given the United States. In view of the disposition which we make of this case it is not necessary to consider that point. For the purposes hereof we assume that the claim belongs to and is made by the United States subject only to its agreement to share the loan proceeds and losses ratably with the Bank.

53 The issue is whether, at the date of bankruptcy, there was a debt which was due the United States within the meaning of R. S. § 3466[2] and which was for that reason entitled to a priority under § 64(a)(5) of the Bankruptcy Act.[3]

The note was made payable to the Bank and was held by the Bank on the date of bankruptcy. In United States v. Marxen, 307 U.S. 200, it was determined that the United States was not entitled to priority on a claim based on a note which had been assigned after bankruptcy upon the payment by the Federal Housing Administrator of a loss under an insurance policy issued pursuant to the National Housing Act. This decision was followed in In re Miller, 2 Cir., 105 F. 2d 926-928, wherein it appeared that the bankrupt obligor had agreed to indemnify the United States for any loss it might sustain by reason of its insurance of the credit. Basically, the rights of the United States in each case were those of a subrogee whereas here the United States participated in the loan. Such participation is said to result in beneficial ownership of a part of the debt on the date of bankruptcy and, hence, to render

54 unimportant the fact of post-bankruptcy assignment.

On the facts of the case at bar we deem it unnecessary to decide whether the United States has any greater rights

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[2] 31 U.S.C. § 191, which provides in part that "debts due to the United States shall be first satisfied" out of the estate of an insolvent debtor.

[3] 11 U.S.C. § 104(a)(5), which allows a fifth priority to "debts owing to any person, including the United States, who by the laws of the United States is[s] entitled to priority."

as a participant in a loan pursuant to the Small Business Act of 1953[4] than it had as a subrogee under an insurance policy issued by it under the National Housing Act. The claim of the United States rests on the premise that it is asserting a debt covered by § 3466 and recognized by § 64(a)(5) of the Bankruptcy Act. While § 3466 must be construed liberally to effectuate its purpose to protect the public finances,[5] the Court said in Marxen that:[6]

> "* * * this principle of construction is subject to the limitation that the generality of the language of the section is restricted by the purpose to grant priority to the United States only, and by legislative intention, as shown by other statutes."

In the Small Business Act of 1953, Congress declared the policy that the government should aid the interests of small business concerns "to preserve free competitive enterprise."[7] To attain that end the administrator of the act is empowered, among other things, to make loans to small business concerns either directly or "in cooperation with banks * * * through agreements to participate * * *."[8] Thus, the United States went to the financial aid of small business by the general extension of credit which otherwise would have been available only from private lending institutions. The United States entered upon a commercial venture which supplemented the activities of private business.

The argument is advanced that by so doing, the United States intended to forego the applicability of § 3466 because the assertion of the priority provided thereby would not benefit small business but would handicap it in its efforts to operate with private financing. The situation is said to be analogous to that considered in United States v. Guaranty Trust Company of New York, 280 U.S. 478, where

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[4] 15 U.S.C. §§ 631-647.

[5] United States v. Emory, 314 U.S. 423, 426. Cf. United States v. Johnson, 10 Cir., 87 F. 2d 155, 161.

[6] 307 U.S. 206.

[7] 15 U.S.C. § 631(a).

[8] 15 U.S.C. § 636(a).

debts incurred under the Transportation Act of 1920 were held to have no priority under § 3466, and distinguishable from United States v. Emory, 314 U.S. 423, where § 3466 was applied to certain transactions under the National Housing Act, the purpose of which was held to be not
56 the strengthening of the general credit of property owners but the stimulation of the business trades. Here again the intriguing arguments presented need not be resolved.

The determining fact is that SBA has by written contract with the Bank agreed to share ratably the proceeds and losses resulting from the transaction with Byquist.

Marxer holds that absent controlling legislation, which is not present here, § 3466 grants priority only to the United States. In Nathanson v. National Labor Relations Board, 344 U.S. 25, 28, it was said that § 3466 may not be extended to create a priority for a claim which the United States is collecting for a private party. This principle would be violated if the claim of the United States were here given priority.

The United States is bound by its written contract to account to the Bank for the Bank's 25% share of any collection made under the note. Hence, the Bank would share to that extent in any proceeds resulting from the award of a priority to the United States. No such priority in a private creditor is provided by § 3466.

The Bankruptcy Act is intended to bring about an equitable distribution of the bankrupt's estate among creditors holding just demands.[9] The use of § 3466
57 to prefer the Bank over the other private creditors would defeat that intent.

The United States has engaged in a commercial enterprise and made no effort to safeguard its rights under § 3466. In a contract made on its own forms it has agreed to share ratably proceeds and losses. It may not assert a priority which will produce a recovery that by contract must be divided with a private entity.

Affirmed.

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[9] Kothe v. R. C. Taylor Trust, 280 U.S. 224, 227.

Judgment—Nov. 6, 1959

This cause came on to be heard on the transcript of the record from the United States District Court for the District of Kansas and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this court that the judgment of the said district court in this cause be and the same is hereby affirmed.

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59 Clerk's Certificate to foregoing Transcript
(omitted in printing)

No. ....., October Term, 1959

(Title omitted)

Order Extending Time to File Petition for Writ of Certiorari—January 25, 1960

UPON CONSIDERATION of the application of counsel for petitioner,

IT IS ORDERED that the time for filing petition for writ of certiorari in the above-entitled cause be, and the same is hereby, extended to and including February 24th, 1960.

CHARLES E. WHITTAKER
Associate Justice of the Supreme Court of the United States.

Dated this 25th day of January, 1960.

61 SUPREME COURT OF THE UNITED STATES

No. 729, October Term, 1959.

SMALL BUSINESS ADMINISTRATION, *Petitioner*,

v.

G. M. McCLELLAN, *Trustee*

Order Allowing Certiorari—April 18, 1960

The petition herein for a writ of certiorari to the United States Court of Appeals for the Tenth Circuit is granted, and the case is transferred to the summary calendar.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

☆ U. S. GOVERNMENT PRINTING OFFICE 1960—549866/P. O. 1422

FILE COPY

No. ~~230~~ ~~229~~ 42

In the Supreme Court of the United States

OCTOBER TERM, 1959

SMALL BUSINESS ADMINISTRATION, PETITIONER

v.

G. M. McCLELLAN, TRUSTEE

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

J. LEE RANKIN,
Solicitor General,
GEORGE COCHRAN DOUB,
Assistant Attorney General,
MORTON HOLLANDER,
MARK R. JOELSON,
Attorneys,
Department of Justice, Washington 25, D.C.

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CITATIONS

In the Supreme Court of the United States

OCTOBER TERM, 1959

No. ——

SMALL BUSINESS ADMINISTRATION, PETITIONER

v.

G. M. McCLELLAN, TRUSTEE

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

The Solicitor General, on behalf of the Small Business Administration and the United States, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Tenth Circuit entered in this case on November 6, 1959.

OPINIONS BELOW

The opinion of the United States District Court for the District of Kansas (R. 40)[1] is reported at 168 F. Supp. 483. The opinion of the court of appeals (App., *infra,* pp. 23–28) is reported at 272 F. 2d 143.

JURISDICTION

The judgment of the court of appeals was entered on November 6, 1959 (App., *infra,* p. 29). On Jan-

[1] All record references are to the pages of the "Transcript of Record" printed for the use of the court of appeals and filed here pursuant to Rule 21 of this Court.

uary 25, 1960, Mr. Justice Whittaker extended the time to file a petition for a writ of certiorari to and including February 24, 1960. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether, where an agency of the United States participates with a private financial institution in making a loan, the agency must be denied the debt priority granted the United States by R.S. § 3466 solely because, by virtue of the participation agreement between the two, the financial institution will share ratably in any amounts recovered on the loan by the Government agency.[2]

STATUTES INVOLVED

1. Section 64 of the Bankruptcy Act, as amended, 11 U.S.C. 104, provides in pertinent part:

§ 104. *Debts which have priority.*

(a) The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be * * * (5) debts owing to any person, including the United

[2] In the event that certiorari should be granted, the Government would ask the Court to decide, in addition to the question presented in this petition, the other important issues expressly left undecided by the court below (App., *infra*, pp. 23–28): (1) whether debts due to the Small Business Administration are "debts due to the United States" within the meaning of R.S. § 3466, and (2) whether, by virtue of its immediate participation in the loan, the S.B.A. became beneficial owner of a 75 percent interest in the debt prior to the filing of the petition in bankruptcy.

States, who by the laws of the United States i[s] entitled to priority * * *.

2. Section 3466 of the Revised Statutes, 31 U.S.C. 191, provides:

§ 191. *Priority established.*

Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed.

STATEMENT

This suit was brought by the Small Business Administration, on behalf of the United States, to review the order of a referee in bankruptcy denying the Small Business Administration's claim to priority on a debt owing from the bankrupt.

On October 8, 1956, S. H. Byquist submitted an application for a $20,000 loan to the Brookville State Bank of Brookville, Kansas (R. 17–26). The application was on a Small Business Administration form and was directed primarily to the Small Business Administration ("S.B.A.") (R. 17). The bank endorsed Byquist's application, indicating that it would make the loan requested, but only on condition that

the S.B.A. participate in the loan immediately to the extent of 75 percent, that is, $15,000 (R. 26).

On November 2, 1956, the S.B.A. approved the loan and agreed to participate in it immediately (R. 27–28). A "Participation Agreement" was entered into by the S.B.A. and the Brookville State Bank which provided, *inter alia,* that the S.B.A. would, upon written demand by the bank, purchase from the bank a 75 percent participation of each disbursement made to Byquist (R. 6). It was also provided that the bank would hold the note, but that if the S.B.A. should make a written demand therefor, the bank would transfer the note to the S.B.A. within five days (R. 9). In addition, the agreement contained the following provisions (R. 9–10):

> 12. Administration of Loan.—The holder of the Note shall receive all payments on account of principal of, or interest on, the Loan and promptly remit to the other party its pro rata share thereof determined according to their respective interests in the Loan * * *.
>
> * * * * *
>
> 14. Liability and Representations.—* * * neither party shall be liable to the other for any loss, not due to its own gross negligence, but such loss, shall be borne ratably by S.B.A. and Bank in accordance with their respective interests in the Loan.

In compliance with this agreement and upon demand of the bank, the S.B.A. sent a check for $15,000, dated November 23, 1956, and drawn on the Treasurer of the United States, to the bank for purchase of a

75 percent interest in the loan to Byquist (R. 16, 30).[3] The bank then loaned Byquist $20,000 (R. 33–34, 42). This loan was evidenced by a note,[4] dated November 16, 1956, to the order of the bank (R. 10–14).

An involuntary petition in bankruptcy was filed with respect to Byquist on August 17, 1957, and he was adjudged a bankrupt on September 5, 1957 (R. 40). On October 22, 1957, a trustee was appointed (R. 40). He proceeded with the liquidation of the estate and holds a sum somewhat in excess of $19,000 (R. 34, 40). Claims totaling $43,682.07 have been filed

[3] Upon receipt of the Government check, the bank executed and delivered to the S.B.A. a participation certificate as evidence of the purchase by the S.B.A. of its interest in the loan. While the executed "Participation Certificate" (S.B.A. form 152) was not in the record before the district court, its execution by the bank is not questioned. The text of the certificate is as follows:

PARTICIPATION CERTIFICATE

BROOKVILLE STATE BANK (hereinafter called "Bank"), hereby certifies that Small Business Administration (hereinafter called "SBA") has purchased from Bank a participation of 75% of $20,000.00, representing the amount of the disbursement, or the aggregate amount of the disbursements (as the case may be) made by Bank on the 23rd day of November 1956, and remaining unpaid on the date of such purchase, on account of a loan by Bank to S. H. Byquist, d/b/a Western Distributors, Salina, Kansas, in an amount not exceeding $20,000.00, such purchase having been made pursuant to a Participation Agreement dated November 19, 1956, between SBA and Bank.

Dated: November 23, 1956

By [S] Brookville State Bank (Bank)
R. D. Powers
Cashier (Title)
Brookville, Kansas (Address)

[4] This note is on another S.B.A. form which is headed "Note (For Limited Loan Participation Only)" (R. 10).

and the cost of administration has been estimated at $6,500.00 by the trustee (R. 34).

Subsequent to the date of Byquist's bankruptcy, the bank assigned his note to the S.B.A. (R. 34). The S.B.A., on behalf of the United States, filed a priority claim in the bankruptcy proceedings under Section 64 of the Bankruptcy Act, 11 U.S.C. 104, *supra*, p. 2, which provides that "debts owing to any person, including the United States, who by the laws of the United States, i[s] entitled to priority" are accorded fifth priority in bankruptcy. The S.B.A. claimed such priority "by the laws of the United States" over the other unsecured creditors by virtue of R.S. § 3466, 31 U.S.C. 191, *supra*, p. 3, which establishes that "debts due to the United States shall be first satisfied" out of the estate of an insolvent debtor. The S.B.A. filed a claim for the sum of $16,788.42, representing the entire amount still unpaid on the note, with interest through October 15, 1957 (R. 4). Recognizing, however, that 25 percent of this claim represents an amount owed by the bankrupt to the bank, the Government has, throughout these proceedings, in fact claimed priority only for $12,266.77, its 75 percent interest in the debt (R. 36).[5]

[5] The $12,266.77 sought by the S.B.A., and for which priority is here asserted, represents the extent to which the S.B.A.'s $15,000 participation in the loan remains unpaid. Since the bank's 25 percent interest in the debt was assigned to the S.B.A. subsequent to the date of bankruptcy, this portion of the debt remained, for bankruptcy purposes, a claim of the bank. While the court of appeals' opinion does not indicate that the Government's priority claim was for only $12,266.77, the amount due it, and not for the $16,788.42 owing

The referee in bankruptcy denied the S.B.A.'s claim to priority on the ground that the S.B.A. is not entitled to the debt priority accorded to the United States by R.S. § 3466, 31 U.S.C. 191 (R. 35–38). The claim was allowed only as an unsecured claim (R. 38). On review, the United States District Court for the District of Kansas rejected the referee's conclusion that the S.B.A. could not claim the debt priority accorded to the United States, but, nevertheless, affirmed the referee's order on the ground that there was no debt due the S.B.A. when the petition in bankruptcy was filed (R. 43–45). In support of its decision, the court pointed out, *inter alia,* that the note executed by the bankrupt was made payable to the bank only, that the S.B.A. paid its $15,000 share of the loan to the bank, and that the bank paid the full amount of the loan to the bankrupt (R. 45). Accordingly, the court held that, since under *United States* v. *Marxen,* 307 U.S. 200,[6] the status of a claim against a bankrupt's estate is determined on the date the petition is filed, and since an assignment after that date cannot give an assignee any greater rights than those of his assignor, the S.B.A.'s claim to priority must be denied (R. 45–46).

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on the entire loan, this fact was made clear by the Government throughout the proceedings. The court of appeals failed to make this plain in its opinion presumably because, in view of its reasoning, the amount for which the S.B.A. was claiming priority was irrelevant.

[6] The district court ignored the Government's contention that unlike *Marxen*, the Government became beneficial owner of its interest in the claim prior to the petition in bankruptcy—that is, at the time the federal payment was made to the bank, more than nine months before the petition was filed. See pp. 4–5, *supra.*

On appeal by the United States, the Court of Appeals for the Tenth Circuit affirmed, but on still another ground. The court assumed, *arguendo,* that the Small Business Administration is entitled to the statutory priority granted the United States (App., *infra,* p. 25). Further, it assumed, *arguendo,* that, by virtue of its immediate participation in the loan, the Small Business Administration became beneficial owner of a 75 percent interest in the debt prior to the filing of the petition in bankruptcy, thus rendering unimportant the post-bankruptcy assignment of the note (App., *infra,* p. 26). The court ruled that, in any event, the S.B.A. could not assert a priority for the amount owing to it because, in its participation agreement with the bank, it had agreed to share ratably the proceeds and losses resulting from the transaction with the borrower. The court stated (App., *infra,* pp. 27–28):

> In *Nathanson* v. *National Labor Relations Board,* 344 U.S. 25, 28, it was said that § 3466 may not be extended to create a priority for a claim which the United States is collecting for a private party. This principle would be violated if the claim of the United States were here given priority.
>
> The United States is bound by its written contract to account to the Bank for the Bank's 25% share of any collection made under the note. Hence, the Bank would share to that extent in any proceeds resulting from the award of a priority to the United States. * * *
>
> * * * * *

> * * * [The United States] may not assert a priority which will produce a recovery that by contract must be divided with a private entity.

REASONS FOR GRANTING THE WRIT

The holding of the court of appeals is, in effect, that whenever an agency of the United States participates with a private financial institution in making a loan, and the participation contract between the two provides for the pro rata sharing of the gains and losses on the transaction, the Government agency must be denied, *in toto*, the debt priority accorded the United States by statute. We submit that this holding misinterprets this Court's decision in *Nathanson* v. *National Labor Relations Board*, 344 U.S. 25, and erroneously confines within narrow limits the scope of R.S. § 3466, an important statute designed to protect federal funds. Since the decision below will have far-reaching and severe detrimental effects on extensive Government lending activities, review by this Court is warranted.

The decision has placed not only the S.B.A., but also other Government agencies administering similar programs, in a critical dilemma with respect to whether or not to alter the nature of their participation lending activities. Any modification by them of their participation agreements so as to avoid the impact of the decision below would tend to make private lending institutions unwilling to take part in the Government programs. These extensive and important participation lending programs, explicitly authorized and fostered by Congress, would thus be defeated.

The alternative—letting the participation agreements remain unmodified—would, under the ruling of the Tenth Circuit, result in leaving the vast sums of money which are disbursed by the Government in connection with these programs completely unprotected by any priority right. And, even if all the agencies concerned should modify their future contracts (a course of action which, as indicated above, would be highly undesirable), the Government would still lose its priority right, under the ruling below, with respect to the hundreds of millions of dollars by which it has committed itself pursuant to participation agreements already in effect.

1. R.S. § 3466, granting the United States a priority with respect to debts, was enacted "in order to secure an adequate revenue to sustain the public burdens * * *." *United States* v. *State Bank of North Carolina*, 6 Pet. 29, 35; *Price* v. *United States*, 269 U.S. 492, 500; *United States* v. *Emory*, 314 U.S. 423, 426. Accordingly, this Court has repeatedly stated that the statute must be given a liberal construction which will effectuate this purpose. *United States* v. *State Bank of North Carolina, supra; Price* v. *United States, supra; United States* v. *Emory, supra; Bramwell* v. *U.S. Fidelity Co.*, 269 U.S. 483; *United States* v. *Marxen*, 307 U.S. 200.

In *Nathanson* v. *National Labor Relations Board*, 344 U.S. 25, the Board had ordered an employer to pay certain employees back wages which they had lost because of an unfair labor practice committed by the employer. When the employer went into bankruptcy, the Board asserted priority under R.S. § 3466 for the

amounts due the employees. This Court held that the back-pay claim was not one entitled to priority under R.S. § 3466 since (344 U.S. at 27–28):

> The priority granted by that statute was designed "to secure an adequate revenue to sustain the public burthens and discharge the public debts." See *United States* v. *State Bank*, 6 Pet. 29, 35. There is no function here of assuring the public revenue. The beneficiaries of the claims are private persons * * *.
>
> * * * We cannot extend that reasoning so as to give priority to a claim which the United States is collecting for the benefit of a private party.

We believe it clear that the reasoning of this Court in *Nathanson* is inapplicable to the completely different situation involved in the instant case.[7] In the present case, the United States is *not* asserting its priority so as to collect any amounts owed to private parties, but is merely seeking to recover the precise sum which the transaction with the bankrupt caused to be disbursed from the Treasury and which is still outstanding. Furthermore, in contrast to the *Nathanson* case, 75 percent of the amount recovered here by the United States will actually be returned to the Treasury,[8] thus effectuating the purpose of the priority statute. And, although the remaining 25 percent of the amount recovered by the United States from

[7] The district court agreed with the Government that the *Nathanson* case is inapplicable here, rejecting the contention of the trustee which ultimately became the ground of decision of the court of appeals (R. 44).

[8] In *Nathanson*, of course, 100 percent of the back pay award was to go to the private employees.

the bankrupt will be remitted to the Brookville State Bank, this payment to the bank will occur by virtue of an independent contractual obligation undertaken by the United States and not, as in *Nathanson*, because the sum is owed by the bankrupt directly to the private party. Yet, despite these crucial distinctions, the court below, relying on the *Nathanson* decision, has ruled that the claim of the United States for priority in this case must be denied in its entirety.

The view of the court of appeals that granting the S.B.A. a priority here would give the private bank an undue advantage over the other private creditors is untenable. The bank will recover the same proportion of its claim in the bankruptcy proceeding as the other private creditors. Any additional amounts that it may recover from its advance to the bankrupt will be solely by virtue and because of its agreement with the S.B.A., which is entirely independent of the bankruptcy proceeding. This independent agreement between the S.B.A. and the bank, providing for the sharing of proceeds and losses, cannot properly be considered with respect to the question of whether the S.B.A.'s claim is entitled to statutory priority in the bankruptcy proceeding.

The crucial consideration, we believe, is that, quite apart from its dealings with the bank, the S.B.A. is owed by the bankrupt the $12,266.77 here claimed, an amount which has, in fact, been advanced from the Treasury. Since the S.B.A. is claiming an amount no greater than that owed directly to it, it can be no concern of the private creditors what the S.B.A. does with the sum after collecting it, or what contractual

arrangements it may have with respect to it. These creditors are in no worse position and collect no less if the S.B.A. remits part of its recovery to the bank than would be the case if there were no contract providing therefor and the S.B.A. retained its entire recovery. It is difficult to see, then, by what reasoning the trustee in bankruptcy can be permitted to seize on an independent contractual undertaking of the United States to defeat the United States' claim for priority with respect to a sum to which it is admittedly entitled. The Tenth Circuit's decision produces this paradoxical and erroneous result.

2. In 1953, Congress enacted the Small Business Act, 67 Stat. 232, to implement its view that the security and economic well-being of the Nation requires the development and encouragement of small business enterprises. Sec. 202, 67 Stat. 232; see 72 Stat. 384, 15 U.S.C. 631.[9] The Act created the Small Business Administration, an unincorporated federal agency subject to the direction and supervision of the President and financed by funds originating from congressional appropriations, to carry out the Congressional policies. Sec. 204, 67 Stat. 233; see 15 U.S.C. 633. Among the powers which Congress has granted the S.B.A. was that of making loans to small business concerns, "either directly or in cooperation with banks or other lending institutions through agreements to participate on an immediate or deferred basis." Sec. 207(a), 67

[9] After several amendments, the Act was reenacted in 1958. 72 Stat. 384, 15 U.S.C. 631–651. All the sections of the 1953 Act which are cited in this petition have been reenacted in virtually identical form in the 1958 Act.

Stat. 236; 15 U.S.C. 636(a). With respect to such loans, the statute prescribed specifically (Section 207(a)(1), 67 Stat. 236; 15 U.S.C. 636(a)(2)):

> [N]o immediate participation may be purchased unless it is shown that a deferred participation is not available;[10] and no loan may be made unless it is shown that a participation is not available * * *.

These restrictions on the S.B.A.'s lending activities were imposed by Congress to effectuate its policy that private lending institutions, and not the Government, should continue to be the principal source of credit for small business. See S. Rep. No. 604, 83d Cong., 1st Sess. 2–3; H. Rep. No. 494, 83d Cong., 1st Sess. 6. Thus, under the statutory scheme participations are preferred to 100% Government loans in order to insure that private loan aid is enlisted to whatever extent it is available.

(*a*). In view of the statutory mandate, most of the business loans advanced by the S.B.A. have been, and will continue to be, made in participation with a private lending institution. As of October 31, 1959, 64.3% of the business loans approved by the S.B.A.

[10] When participation is immediate (as in this case), the S.B.A. pays the bank the amount by which it has obligated itself simultaneously with the bank's advancing the loan funds to the borrower. In a deferred participation, the S.B.A. makes disbursement at a later date, but only if and when the bank so requests. Since the distinction between the two types of participation is only with respect to the time when the Government funds are advanced, it is not relevant for our purposes. Both immediate and deferred participation agreements contain a clause providing for the pro rata sharing of gains and losses on the loan transaction.

had been of the participation type, totalling $446,302,000.[11] On that same date, the S.B.A. had 7,201 participation loans outstanding, in which the S.B.A.'s participation amounted to $216,410,000. In addition to business loans, the S.B.A. is also empowered to make, either directly or in participation, disaster loans which it determines to be necessary or appropriate because of floods or other catastrophes. Sec. 207(b), 67 Stat. 236; 15 U.S.C. 636(b). Some 11.5% of such loans have been made in participation (the statute does not prescribe a preference for participation loans in this regard), and the S.B.A.'s interest in such disaster participation loans outstanding on October 31, 1959, was $7,353,000.

Since the provision relating to the sharing of profits and losses is in all the currently outstanding participation agreements of the S.B.A., the rule enunciated by the court below would have the effect of denying the S.B.A. a right to priority with respect to the $223,763,000 to which it has currently committed itself in participation loans. And the question of priority is of particular significance, since S.B.A. business loans, because of statutory prerequisites as to their availability, are primarily extended to concerns whose insolvency is not unlikely. Thus, the risk of loss by the Government on this sum of $223,763,000 is indeed substantial.

(*b*). As for all of its future loans, the only practicable way for the S.B.A. to avoid the impact of the

[11] This statistical information, as well as the other detailed information concerning the activities of the Small Business Administration contained in this petition, was furnished by the General Counsel's Office of the S.B.A.

decision below would be for it to revise its participation agreement forms so as to include a provision declaring that the participating bank will not be entitled to share in any recovery obtained by the S.B.A. by reason of its right to priority. Such an arrangement would be highly unattractive to prospective bank participants—on whose willingness to take part the success or failure of a participation program wholly depends. The possibility of being indemnified, at least in part, by the United States, which is more likely to collect its debts because of its right of priority, provides a strong incentive for banks to participate in the S.B.A.'s program. Furthermore, the banks would be often unable to share in the recovery of the S.B.A., while forced to divide their collections with the S.B.A. Thus, the Small Business Administration, in response to an inquiry as to whether modification of its participation agreements would be feasible, has replied: [12]

> * * * the inclusion of such a provision would, in our opinion, substantially defeat the purposes of the bank participation program. It is unlikely that many lending institutions would be willing to participate in a loan, or make a loan in participation with this Agency, if the lending institution was obligated to share with this Agency any and all collections it made, but this Agency was not obligated to share with the lending institution any collections it received by reason of its right to priority of payment. * * *

[12] Letter of December 10, 1959, to the Department of Justice, from the Small Business Administration.

The decision below thus poses for the S.B.A. the dilemma of having either to lose its right of priority with respect to all its future participation loans, or else to amend its participation arrangement, and thereby risk frustration and failure of the participation lending program which Congress has prescribed for aiding the small businessman.

(*c*). The decision below may produce other undesirable and far-reaching consequences. Since it, in effect, denies the S.B.A. a right of priority on all sums advanced by it under its present participation program, the ruling of the Tenth Circuit may well have the effect of making a small business's creditors eager to push the business into bankruptcy immediately after it receives an S.B.A. participation loan in order to reap a benefit from the loan funds. On that basis, instead of aiding and encouraging the continued operation of a small business, the S.B.A. loan would hasten its demise. On the other hand, if the S.B.A. were allowed priority on its advances, creditors would have nothing to gain from an immediate bankruptcy, and the loan's purpose—to stimulate confidence in the business and to enable it to continue functioning—would more likely be served. Similarly, under the Tenth Circuit's view, creditors will be tempted to induce small businesses to obtain S.B.A. participation loans merely for the creditors' benefit in the event of bankruptcy. Such a purpose in securing a loan would not fulfill any of the objectives of the Act and, indeed,

is contrary to the S.B.A.'s regulations. 13 C.F.R. 120.4–2(d)(1)(i).[13]

3. Soon after the outbreak of the Korean conflict, Congress enacted the Defense Production Act of 1950, 64 Stat. 798, 50 U.S.C. App. 2061, to provide, *inter alia*, a wide variety of incentives to increase productive capacity and the supply of materials and services needed for defense. Section 301 of the Act empowered the President to authorize various procurement agencies of the United States to guarantee loans made by public or private financing institutions, "for the purpose of financing any contractor, subcontractor, or other person in connection with the performance of any contract or other operation deemed by the guaranteeing agency to be necessary to expedite production and deliveries or services under Government contracts for the procurement of materials or the performance of services for the national defense." 64 Stat. 800, as amended, 50 U.S.C. App. 2091(a).[14] The agencies so

[13] Furthermore, in many situations it will be obviously unjust to deny the S.B.A. priority on its debt claim in bankruptcy because the proceeds of the S.B.A.'s loan funds will comprise the bulk of the bankruptcy. S.B.A. participation loans, by necessity, go to small businesses that are not wholly prosperous and that cannot get credit from other sources. When such a business goes into bankruptcy, its remaining funds will often be traceable to the S.B.A. loan. Thus, it is hardly a coincidence that, in the case at bar, a $20,000 participation loan was extended, and $19,000 is the amount in the trustee's hands—particularly since the involuntary petition in bankruptcy was filed less than a year after the loan was made.

[14] Under the 1953 amendment to the Act, such loans may also be guaranteed in connection with the termination, in the Government's interest, of defense contracts, and small businesses are made eligible for guaranteed loans despite the availability of alternative sources of supply. 67 Stat. 129, 50 U.S.C. App. 2091(a).

amed have been the Departments of the Army, Navy, nd Air Force, the Atomic Energy Commission, the eneral Services Administration, and the Depart-ents of Commerce, Interior, and Agriculture. E.O. 480, 18 F.R. 4939.

Under this program, known as the "V-loan" pro-ram, a defense contractor first approaches a private nk, and the bank then asks one of the above-named overnment agencies to guarantee the loan in whole in part. If the agency approves the loan, the Fed-al Reserve Bank, acting as fiscal agent of the gency, will enter into the guarantee agreement with e lender.[15] . This agreement between the private stitution and the Federal Reserve Bank is really ne of deferred participation by the United States, ther than of guarantee, because the standard V-loan greement provides that the Government agency is bligated to purchase a stated percentage of the loan demand of the lending bank, and that all collec-ons and losses on the loan are to be shared ratably tween the bank and the Government agency.[16] nce, therefore, the V-loan program is, in all rele-nt respects, similar to the S.B.A. participation rogram, the adverse effect of the decision below ould apply to it with equal force.

From the inception of the V-loan program in 1950, rough April 1958, the Government agencies admin-

[15] See *Report of the Attorney General Pursuant to Section 8(e) of the Defense Production Act of 1950, as amended*, ugust 8, 1958, pp. 18–21.

[16] "Section 301 of the Act, 64 Stat. 800, 50 U.S.C. App. 91(a), suggests that V-loan guarantees be accomplished by greement to share losses * * *."

istering the V-loan program have guaranteed in the above manner $2.4 billion in loans. *Report of the Attorney General, supra,* p. 28. As of December 31, 1959, ninety-five V-loans were outstanding.[17] Of these, in only five does the Government guarantee extend to 100%. The Government's interest in the remaining ninety loans—in all of which the guarantee agreements provide for the sharing of gains and losses—is $252,000,000.

With regard to the future, amendment of the V-loan agreement would carry with it much the same objections as those presented above with reference to modification of the S.B.A. participation program. In this connection, Mr. Merritt Sherman, Secretary of the Board of Governors of the Federal Reserve System, states:[18]

> The present V-loan program, like the similar wartime program, is designed to encourage participation by private financing institutions in the making of loans to contractors engaged in production or services deemed necessary for the national defense, especially where, because of ordinary credit rules, such financing would

[17] In addition, Section 302 of the Defense Production Act of 1950, 64 Stat. 801, 50 U.S.C. App. 2092, empowers the President to make provision for loans, including participations, to business enterprises to aid defense production. In making loans pursuant to this section, the Treasury Department has favored participation loans rather than direct loans. *Report of the Attorney General, supra,* pp. 14–15. Since the participation agreements in this program also provide for the sharing of gains and losses, this program would also be directly and adversely affected by the decision below.

[18] Letter of January 20, 1960, to the Department of Justice from the Board of Governors of the Federal Reserve System.

not be forthcoming without a certain degree of Government protection. Consequently, the agreement of the guaranteeing Government agency to share losses according to the respective interests of the guaranteeing agency and the financing institution has constituted an essential element of the V-loan program since its inception in 1942.

4. In sum, Congress and the Executive have viewed the joint participation of private lending firms and Government agencies in lending programs as an appropriate and desirable method of encouraging business concerns which, in the absence of Government participation, would be unable to borrow capital. In particular, the participation loan program administered by the Small Business Administration was devised by Congress as an effective means to sustain the small business concerns regarded by it as essential to the economic well-being of the Nation. The V-loan program, similarly, was devised to assure that defense production would not be impeded because of an unavailability of capital. The erroneous decision below, if allowed to stand, will seriously undermine these participation programs by forcing the administering agencies to alter them and thereby risk their impairment, or else to forego the right of priority accorded by statute to debts owing the United States. And even if the participation programs were to be amended, the view taken by the Tenth Circuit would result in the denial to the United States of a right of priority with respect to the almost half billion dollars in government participations currently outstanding.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that this petition for a writ of certiorari should be granted.

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FEBRUARY 1960.

APPENDIX

United States Court of Appeals for the Tenth Circuit

No. 6117—September Term, 1959

SMALL BUSINESS ADMINISTRATION, APPELLANT,

v.

G. M. MCCLELLAN, TRUSTEE, APPELLEE.

Appeal from the United States District Court for the District of Kansas.

In the matter of S. H. Byquist, an individual, doing business as Western Distributors, Bankrupt.

Morton Hollander, Attorney, Department of Justice (George Cochran Doub, Assistant Attorney General, Wilbur G. Leonard, United States Attorney, and Samuel D. Slade and Peter H. Schiff, Attorneys, Department of Justice, were on the brief) for Appellant.

John Q. Royce for Appellee.

Before BRATTON, LEWIS and BREITENSTEIN, Circuit Judges.

BREITENSTEIN, Circuit Judge.

In this bankruptcy proceeding the court below affirmed a referee's order allowing a claim of Small Business Administration as an unsecured claim and denying it any priority. The only question on ap-

peal is the right to priority over other unsecured creditors.

The facts are not in dispute. Byquist, the bankrupt, applied on a Small Business Administration [1] form, entitled "Limited Loan Participation Application for Loan," to the Brookville State Bank of Brookville, Kansas, for a $20,000 loan. On October 30, 1956, the Bank endorsed the application to show that it was willing to make the loan upon the participation of SBA therein to the extent of 75%. SBA agreed and on November 19, 1956, entered into a "Participation Agreement" with the Bank. Therein it was provided that upon written demand by the Bank SBA would purchase a 75% interest; that the Bank would hold the note and on five days written demand would transfer it to SBA; that the holder of the note would service it and remit promptly to the other party its pro rata share; and that SBA and the Bank were to bear any loss incurred ratably according to their respective interests in the loan.

On November 21, 1956, SBA sent the Bank its check in the amount of $15,000 for the sole purpose of purchasing a 75% interest in the loan. The Bank then loaned $20,000 to Byquist who executed and delivered a note payable to the Bank and made out on an SBA form in which he agreed to use the loan proceeds solely for the purposes set out in the SBA loan authorization and to reimburse the "Holder" and SBA for expenses incurred by them in connection with the loan.

After the filing of an involuntary petition in bankruptcy, Byquist was adjudicated a bankrupt on September 5, 1957, and a trustee was duly appointed. The estate is valued at approximately $19,000 and the claims filed exceed $43,000.

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[1] Hereinafter referred to as SBA.

Subsequent to the date of bankruptcy, the Bank assigned the note to SBA which on October 15, 1957, filed a claim for the unpaid balance amounting to $16,788.42 and claimed priority therefor.

At the outset we have the contention of the trustee that SBA is not an agency of the United States and hence is not entitled to any priority given the United States. In view of the disposition which we make of this case it is not necessary to consider that point. For the purposes hereof we assume that the claim belongs to and is made by the United States subject only to its agreement to share the loan proceeds and losses ratably with the Bank.

The issue is whether, at the date of bankruptcy, there was a debt which was due the United States within the meaning of R.S. § 3466[2] and which was for that reason entitled to a priority under § 64(a)(5) of the Bankruptcy Act.[3]

The note was made payable to the Bank and was held by the Bank on the date of bankruptcy. In United States v. Marxen, 307 U.S. 200, it was determined that the United States was not entitled to priority on a claim based on a note which had been assigned after bankruptcy upon the payment by the Federal Housing Administrator of a loss under an insurance policy issued pursuant to the National Housing Act. This decision was followed in In re Miller, 2 Cir., 105 F. 2d 926–928, wherein it appeared that the bankrupt obligor had agreed to indemnify the United States for any loss it might sustain by

[2] 31 U.S.C. § 191, which provides in part that "debts due to the United States shall be first satisfied" out of the estate of an insolvent debtor.

[3] 11 U.S.C. § 104(a)(5), which allows a fifth priority to "debts owing to any person, including the United States, who by the laws of the United States i[s] entitled to priority."

reason of its insurance of the credit. Basically, the rights of the United States in each case were those of a subrogee whereas here the United States participated in the loan. Such participation is said to result in beneficial ownership of a part of the debt on the date of bankruptcy and, hence, to render unimportant the fact of post-bankruptcy assignment.

On the facts of the case at bar we deem it unnecessary to decide whether the United States has any greater rights as a participant in a loan pursuant to the Small Business Act of 1953[4] than it had as a subrogee under an insurance policy issued by it under the National Housing Act. The claim of the United States rests on the premise that it is asserting a debt covered by § 3466 and recognized by § 64(a)(5) of the Bankruptcy Act. While § 3466 must be construed liberally to effectuate its purpose to protect the public finances,[5] the Court said in Marxen that:[6]

> * * * this principle of construction is subject to the limitation that the generality of the language of the section is restricted by the purpose to grant priority to the United States, only, and by legislative intention, as shown by other statutes.

In the Small Business Act of 1953, Congress declared the policy that the government should aid the interests of small business concerns "to preserve free competitive enterprise."[7] To attain that end the administrator of the act is empowered, among other things, to make loans to small business concerns either directly or "in cooperation with banks.

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[4] 15 U.S.C. §§ 631–647.

[5] *United States* v. *Emory*, 314 U.S. 423, 426. Cf. *United States* v. *Johnson*, 10 Cir., 87 F. 2d 155, 161.

[6] 307 U.S. 206.

[7] 15 U.S.C. § 631(a).

* * * through agreements to participate * * *."[8] Thus, the United States went to the financial aid of small business by the general extension of credit which otherwise would have been available only from private lending institutions. The United States entered upon a commercial venture which supplemented the activities of private business.

The argument is advanced that by so doing, the United States intended to forego the applicability of § 3466 because the assertion of the priority provided thereby would not benefit small business but would handicap it in its efforts to operate with private financing. The situation is said to be analogous to that considered in *United States* v. *Guaranty Trust Company of New York*, 280 U.S. 478, where debts incurred under the Transportation Act of 1920 were held to have no priority under § 3466, and distinguishable from *United States* v. *Emory*, 341 U.S. 423, where § 3466 was applied to certain transactions under the National Housing Act, the purpose of which was held to be not the strengthening of the general credit of property owners but the stimulation of the business trades. Here again the intriguing arguments presented need not be resolved.

The determining fact is that S.B.A. has by written contract with the Bank agreed to share ratably the proceeds and losses resulting from the transaction with Byquist.

Marzen holds that absent controlling legislation, which is not present here, § 3466 grants priority only to the United States. In Nathanson v. National Labor Relations Board, 344 U.S. 25, 28, it was said that § 3466 may not be extended to create a priority for a claim which the United States is collecting for a

[8] 15 U.S.C. § 636(a).

private party. This principle would be violated if the claim of the United States were here given priority.

The United States is bound by its written contract to account to the Bank for the Bank's 25% share of any collection made under the note. Hence, the Bank would share to that extent in any proceeds resulting from the award of a priority to the United States. No such priority in a private creditor is provided by § 3466.

The Bankruptcy Act is intended to bring about an equitable distribution of the bankrupt's estate among creditors holding just demands.* The use of § 3466 to prefer the Bank over the other private creditors would defeat that intent.

The United States has engaged in a commercial enterprise and made no effort to safeguard its rights under § 3466. In a contract made on its own forms it has agreed to share ratably proceeds and losses. It may not assert a priority which will produce a recovery that by contract must be divided with a private entity.

Affirmed.

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* *Kothe* v. *R. C. Taylor Trust*, 280 U.S. 224, 227.

JUDGMENT

Thirty-eighth Day, September Term, Friday, November 6th, 1959

Before Honorable SAM G. BRATTON, Honorable DAVID T. LEWIS and Honorable JEAN S. BREITENSTEIN, *Circuit Judges.*

This cause came on to be heard on the transcript of the record from the United States District Court for the District of Kansas and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this court that the judgment of the said district court in this cause be and the same is hereby affirmed.

U.S. GOVERNMENT PRINTING OFFICE 1960

FILE COPY

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1959.

No. ~~229~~. 42

SMALL BUSINESS ADMINISTRATION,
Petitioner,

vs.

G. M. McCLELLAN, Trustee,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS, TENTH CIRCUIT.

BRIEF FOR RESPONDENT IN OPPOSITION.

JOHN Q. ROYCE,
Salina, Kansas,
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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1959.

No. 729.

SMALL BUSINESS ADMINISTRATION,
Petitioner,

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G. M., McCLELLAN, Trustee,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS, TENTH CIRCUIT.

BRIEF FOR RESPONDENT IN OPPOSITION.

OPINIONS BELOW.

This proceeding originated in bankruptcy in the United States District Court for the District of Kansas. The first decision was made by the Honorable E. R. Sloan, Referee in Bankruptcy. That opinion is unreported, but is contained in the record at pages 35 through 38. A petition for review was filed. The opinion of the United States

District Court for the District of Kansas on the petition for review is reported at 168 F. Supp. 483, and appears in the record at pages 40 through 46. An appeal was taken to the United States Court of Appeals for the Tenth Circuit. The opinion of the Court of Appeals is reported in 272 F.2d 143.

JURISDICTION.

The jurisdiction of this court is invoked under 28 U.S.C. 1254 (1). The jurisdictional requisites are set forth in the petition.

STATUTES INVOLVED.

The statutes involved are:

1. Section 64, Fifth (11 U.S.C. § 104 (5)) of the Bankruptcy Act providing a priority of the Fifth Class to "debts owing to any person, including the United States, who by the laws of the United States is entitled to priority, * * *";

2. R.S. § 3466 (31 U.S.C. § 191) which provides, "whenever any person indebted to the United States is insolvent, * * * the debt due to the United States shall be first satisfied; * * *"; and,

3. The Small Business Act of 1953, as amended, 15 U.S.C. §§ 631-651, which was in effect at the time of the commencement of this litigation, particularly 15 U.S.C. § 631 (a), which provides:

> "The essence of the American economic system of private enterprise is free competition. Only through full and free competition can free markets, free entry into business and opportunities for the expression and

growth of personal initiative and individual judgment be assured. The preservation and expansion of such competition is basic not only to the economic well-being but to the security of this Nation. Such security and well-being cannot be realized unless the actual and potential capacity of small business is encouraged and developed. It is the declared policy of the Congress that the Government should aid, counsel, assist, and protect insofar as is possible the interests of small business concerns in order to preserve free competitive enterprise, to insure that a fair proportion of the total purchases and contracts for supplies and services for the Government be placed with the small-business enterprises, and to maintain and strengthen the overall economy of the Nation."

and 15 U.S.C. 636 (a) (1):

"(a) The Administration is empowered to make loans to enable small-business concerns to finance plant construction, conversion, or expansion, including the acquisition of land; or to finance the acquisition of equipment, facilities, machinery, supplies, or materials; or to supply such concerns with working capital to be used in the manufacture of articles, equipment, supplies, or materials for war, defense, or essential civilian production or as may be necessary to insure a well-balanced national economy; and such loans may be made or effected either directly or in cooperation with banks or other lending institutions through agreements to participate on an immediate or deferred basis: *Provided, however,* That the foregoing powers shall be subject to the following restrictions and limitations:

"(1) No financial assistance shall be extended pursuant to (a) above unless the financial assistance applied for is not otherwise available on reasonable terms and *all loans made shall be of such sound value or so secured as reasonably to assure repayment;* no immediate participation may be

purchased unless it is shown that a deferred participation is not available; and no loan may be made unless it is shown that a participation is not available."

(The Small Business Act of 1953 was re-enacted in 1958, 72 Stat. 384, 15 U.S.C. §§ 631-651. The provisions of the 1958 act are virtually identical with the provisions of the 1953 act. The language emphasized in 15 U.S.C. 636 (a) (1) above now appears as a separate sub-paragraph, 15 U.S.C. § 636 (a) (7) in the 1958 Act.)

QUESTION PRESENTED.

The question for determination is whether or not the Small Business Administration, under the facts of this particular case and under the Small Business Act of 1953 is entitled to a priority as to seventy-five per cent (75%) of the unpaid portion of a note executed by the bankrupt to the Brookville State Bank.

The question was raised by the Trustee's objection to the allowance of the SBA claim as a priority claim on four grounds:

1. That the act creating the Small Business Administration created a separate and distinct entity which was not invested with the sovereign privileges and immunities of the United States.

2. That this claim was assigned to the Small Business Administration after the date of bankruptcy or insolvency and therefore is not entitled to priority.

3. That the allowance of the priority would be inconsistent with the Small Business Act of 1953, and with other statutes and other acts of Congress.

4. That the allowance of the priority would be inconsistent with the purpose for which the priority was granted.

STATEMENT.

On November 19, 1956, the Small Business Administration and the Brookville State Bank, Brookville, Kansas, entered into a participation agreement between themselves (Exhibit "A", R. 5-10). This agreement recites that S. H. Byquist, d/b/a Western Distributors, "has made application for a loan in the amount of $20,000.00" and "SBA desires to purchase a participation of 75% of the loan or such part thereof as bank may disburse to borrower." (Exhibit "A", R. 5).

By the participation agreement, the Small Business Administration agreed that upon written demand by the bank, it would purchase from the bank a participation of 75% of each disbursement made by the bank (Exhibit "A", ¶ 2, R. 6). It was further agreed that the bank and SBA would share ratably in accordance with their respective interests in the loan any income (Exhibit "A", ¶ 12, R. 9), expenses (Exhibit "A", ¶ 13, R. 9), or losses (Exhibit "A", ¶ 14, R. 10).

The Brookville State Bank did lend S. H. Byquist, d/b/a Western Distributors, $20,000.00. Said loan was evidenced by a promissory note dated November 16, 1956, payable to the order of the Brookville State Bank, Brookville, Kansas (Exhibit "B", R. 10-14). The bank, pursuant to the provisions of paragraph 2 of the participation agreement, made written demand on SBA for purchase of 75% of the disbursement (Exhibit "F", R. 29). Pursuant to the participation agreement and this demand, SBA

sent a check for $15,000.00, dated November 23, 1956, to the bank (Exhibit "C", R. 16), for purchase of its participation in the loan to Byquist.

On September 5, 1957, S. H. Byquist, an individual, d/b/a Western Distributors, was adjudicated a bankrupt (R. 34).

Subsequent to the institution of the bankruptcy proceedings and the adjudication in bankruptcy, the Brookville State Bank assigned the note to Small Business Administration (R. 34).

On October 15, 1957, Small Business Administration duly filed a proof of claim in bankruptcy for the full unpaid balance of the note (R. 3-5).

On November 22, 1957, after all due credits were given, there remained due on said $20,000.00 note the sum of $16,355.69, with interest paid to the date of bankruptcy (R. 34).

The total gross estate in the hands of the Trustee is approximately $19,000.00, against which claims totaling $43,682.07 have been filed (R. 34).

The Trustee duly filed objection to the allowance of the SBA claim as a priority claim on the grounds that the SBA was created as a separate entity and was not invested with the sovereign privileges and immunities of the United States (*Sloan Shipyards Corporation* v. *United States Shipping Board*, 258 U.S. 549, 66 L. Ed. 762; *RFC* v. *J. H. Menihan Corp.*, 312 U.S. 81, 85 L. Ed. 595; *Nathanson* v. *National Labor Relations Board*, 344 U.S. 25, 97 L. Ed. 23); that the assignment of this claim occurred after the date of bankruptcy or insolvency and no debt was due to the Small Business Administration at the date of bankruptcy (*United States* v. *Marxen*, 307 U.S. 200, 83 L. Ed.

1222); that the allowance of the priority would be inconsistent with the Small Business Act of 1953, and other statutes and acts of Congress (*United States* v. *Guaranty Trust Company*, 280 U.S. 478, 74 L. Ed. 556; *National Bank* v. *United States*, 107 U.S. 445, 27 L. Ed. 537; *Davis* v. *Pringle*, 268 U.S. 315, 69 L. Ed. 974); and, that the allowance of the priority would be inconsistent with the purpose for which the priority was granted (*Nathanson* v. *National Labor Relations Board*, 344 U.S. 25, 97 L. Ed. 23; *United States* v. *Marxen*, 307 U.S. 200, 83 L. Ed. 1222).

The Referee denied priority on the ground that the SBA is a separate entity (R. 35-38). The District Court denied priority on the ground that there was a post bankruptcy assignment (168 F. Supp. 483, R. 40-46). The Court of Appeals held the determining fact to be:

> "* * * that SBA has by written contract with the Bank agreed to share ratably the proceeds and losses resulting from the transaction with Byquist.
>
> "Marxen holds that absent controlling legislation, which is not present here, § 3466 grants priority only to the United States. In *Nathanson* v. *National Relations Board*, 34 U.S. 25, 28, it was said that § 3466 may not be extended to create a priority for a claim which the United States is collecting for a private party. This principle would be violated if the claim of the United States were here given priority.
>
> "The United States is bound by its written contract to account to the Bank for the Bank's 25% share of any collection made under the note. Hence, the Bank would share to that extent in any proceeds resulting from the award of a priority to the United States. No such priority in a private creditor is provided by § 3466.
>
> "The Bankruptcy Act is intended to bring about an equitable distribution of the bankrupt's estate

among creditors holding just demands. The use of § 3466 to prefer the Bank over other private creditors would defeat that intent.

"The United States has engaged in a commercial enterprise and made no effort to safeguard its rights under § 3466. In a contract made on its own forms it has agreed to share ratably proceeds and losses. It may not assert a priority which will produce a recovery that by contract must be divided with a private entity." (272 F.2d 143, 145, 146, Petition, Appendix, pp. 27-28).

ARGUMENT.

The facts on which this case was decided were stipulated. On those facts, and the Small Business Act of 1953, the decision of the court below is manifestly correct. There are no questions of importance involved in the decision of this case which have not been previously determined by this court. The Court of Appeals, and the District Court, decided the case on settled principles of law as enunciated by the former decisions of this court. The decision is not in conflict with any decision from any other Court of Appeals. No purpose would be served by granting the writ of certiorari in this case.

The reasons advanced by petitioner for granting the writ of certiorari are not based upon the issues of this case, nor upon any facts in the record in this case, or of which the court may take judicial notice; but rather upon selected statistical information in petitioner's own files, and supported only by quotation of communications from petitioner to its attorneys (See, *e. g.* Petition, p. 15, n. 11; p. 16, n. 12).

The burden of petitioner's argument is that "the decision below will have far reaching and severe detrimental

effects on extensive government lending activities, * * *" (Petition 9). This, in turn, is based on the proposition that "the question of priority is of particular significance, since SBA business loans, because of statutory prerequisites as to their availability, are primarily extended to concerns whose insolvency is not unlikely." (Petition 15). This argument is inappropriate and inapplicable to the facts and law under which this case was decided. The statutory mandate of the Small Business Act of 1953 at the time this loan was made and at the time this litigation commenced was that "all loans made shall be of such sound value or so secured as reasonably to assure repayment." (Small Business Act of 1953, § 207 (a) 1, 15 U.S.C. § 636 (a) 1. See, 1958 Act, 15 U.S.C. § 636 (a) (7)). The intention to rely on other means than the priority provided by § 3466 for obtaining repayment of these loans is clear from the Act.

The Decision Below Is Correct.

SBA has filed a claim against the bankrupt in the sum of $16,788.42. (It was subsequently stipulated that the correct figure after all credits were given was $16,355.69 (R. 34).) This claim is based on a note given by the bankrupt to the Brookville State Bank, and a participation agreement entered into between the Bank and Small Business Administration. In a partial recognition of the participation agreement, SBA has, from the outset, asserted priority only for 75% of the total claim, or $12,266.75.

In this case, if no priorities are allowed, all of the creditors will receive a dividend of approximately 30%. If the priority claimed by SBA were allowed, the greatest dividend the common creditors could expect to receive would be approximately 2% if in fact they received any dividend at all.

Under the participation agreement, it is provided that "loss shall be borne ratably by SBA and Bank in accordance with their respective interests in the loan." (R. 10). If the priority should be allowed as to $12,266.77 of this $16,355.69 claim, and the balance be allowed as a common claim, there would be a total recovery on the claim of $12,348.53, assuming a 2% dividend on the balance. Under the participation agreement on which SBA bases its claim, $3,087.13 of this amount would be payable to the Brookville State Bank.

The Brookville State Bank would therefore receive from the assets of the bankrupt approximately 75% of its claim, while the other common creditors receive only 2%. The Bank, as a common creditor with no superior equities, would thus be preferred over the other common creditors contrary to the purpose of the Bankruptcy Act to bring about an equitable distribution of the bankrupt's estate among creditors holding just demands. The SBA, on the other hand, would not enjoy the fruits of the priority since under the participation agreement it could not retain the amonut for which the priority was allowed.

By the same reasoning by which SBA initially claimed priority to only a $12,266.77, it might claim priority to only $9,261.40, the amount it would be entitled to retain under the distribution set out above. Here, again, however, while the dividend to the common creditors would be somewhat increased, the recovery by SBA by virtue of its priority would have to be shared with the Bank under the participation agreement. This again would result in an inequitable preference of the Bank, and SBA would not retain the amount recovered by virtue of the priority.

The only point at which a dividend can be allowed on this claim without resulting in a sharing by SBA and a

preference to the Bank, thus satisfying and enforcing the provisions of both the participation agreement and the Bankruptcy Act, is by allowance of the claim as a common claim without priority. At that point, and at that point only, the Bank and SBA will share ratably, according to their respective interests in the loan, the loss sustained on this loan, so that no amount will be due by either to the other, and no inequitable preference will result to the Bank.

Insofar as any amount is recovered by the Small Business Administration in excess of an ordinary dividend, a part of that excess must be divided with the Bank. So much of the recovery as must, under the participation agreement, go to the Bank, is not a debt due the United States. The collection of that amount by the Small Business Administration is for the benefit of a private party.

In *United States* v. *Marxen*, 307 U.S. 200, 83 L. Ed. 1222, this court after announcing the principle that § 3466 is to be construed liberally to effectuate its purpose to protect the public revenues said:

> "But this principle of construction is subject to the limitation that the generality of the language of the section is restricted by the purpose to grant priority to the United States, only, and by legislative intention, as shown by other statutes."

In *Nathanson* v. *National Labor Relations Board*, 344 U.S. 25, 97 L. Ed. 23, it was said that § 3466 may not be extended to create a priority for a claim which the United States is collecting for the benefit of a private party.

On the authority of those cases, and a finding that the allowance of a priority in this case would defeat the intent of the Bankruptcy Act to bring about an equitable

distribution of the bankrupt's estate among creditors holding just demands, the Court of Appeals denied priority.

The petitioner attempts to distinguish the Nathanson case on the ground that whereas in that case the entire amount collected would be paid over to private parties, here, a part of the recovery would be retained by the SBA. It also takes the position that the participation agreement between it and the Bank upon which it bases its claim is some side agreement which cannot be considered in the bankruptcy proceeding. The petitioner says:

> "This independent agreement between the SBA and the Bank, providing for the sharing of proceeds and losses, cannot properly be considered with respect to the question of whether the SBA's claim is entitled to statutory priority in the bankruptcy proceeding." (Petition 12).

The SBA has here filed a claim for $16,788.42, of which it concededly is entitled only to a part. To prove that part of the claim which belongs to it, the SBA alleged and proved an agreement with the Brookville State Bank by which it agreed to purchase from the Bank a participation of 75% of each disbursement made by the Bank, and also, that proceeds and losses would be shared in accordance with the respective interests in the loan. This is a single indivisible agreement between SBA and the Bank. It must be read and construed as a whole. The provisions relating to the sharing of proceeds and losses is as much a part of the agreement as the agreement to purchase a participation of the loan initially.

This is no side agreement or independent contractual undertaking. It is the very basis for the determination of the allowance of this claim; the parties entitled to any recovery allowed on the claim; and, whether or not those

parties or either of them are entitled to a priority and to what extent.

Under the Small Business Act of 1953, the SBA had a complete right to enter into the agreement which it made with the Bank; it has the duty to fulfill that obligation. It can only fulfill that obligation in this transaction, and under this agreement, by "bearing the loss" as provided in the agreement. The reimbursement to the Bank must come from the assets of the bankrupt. We submit that the SBA has no right, power or authority to make any reimbursement to the Bank by way of gift, donation or payment to the bank to fulfill the obligation it has undertaken regarding losses in its participation agreement. It can bear the loss; it cannot recover and repay as some side agreement.

The Small Business Act provides for the participation by the Small Business Administration with ordinary commercial banks and other lending institutions. By such participation any claim which might be made by Small Business Administration is so affected by a private non-governmental interest that the allowance of any priority would be inequitable and inconsistent with the purpose of the Small Business Act, the Bankruptcy Act, and inconsistent with the purpose of § 3466 itself.

The Court of Appeals, in its opinion in this case, said:

> "The United States has engaged in a commercial enterprise and made no effort to safeguard its rights under § 3466. In a contract made on its own forms it has agreed to share ratably proceeds and losses. It may not assert a priority which will produce a recovery that by contract must be divided with a private entity."

There is nothing new in this principle. As early as 1824, in *Bank of the United States* v. *Planters Bank*, 9 Wheat

904, 6 L. Ed. 244, this court, in an opinion delivered by Mr. Chief Justice Marshall, said:

> "It is, we think, a sound principle, that when a government becomes a partner in any trading company, it divests itself, so far as concerns the transactions of that company, of its sovereign character, and takes that of a private citizen. Instead of communicating to the company its privileges and its prerogatives, it descends to a level with those with whom it associates itself, and takes the character which belongs to its associates, and to the business which is to be transacted. * * *"

Here the SBA has in effect entered into a partnership or joint venture with an ordinary commercial bank. The interests of the SBA and the Bank in this transaction are inseparable. Any action which affects one of the parties, of necessity, affects the other.

> "The broad purpose of the bankruptcy act is to bring about an equitable distribution of the bankrupt's estate among creditors holding just demands * * *."
> *Kothe* v. *R. C. Taylor Trust*, 280 U.S. 224, 227, 74 L. Ed. 382.

> "The theme of the Bankruptcy Act is 'equality of distribution' (*Sampsell* v. *Emperial Paper & Color Corp.*, 313 U.S. 215, 219, 85 L. Ed. 1293, 1298, 61 S. Ct. 904); and if one claimant is to be preferred over others, the purpose should be clear from the statute."
> *Nathanson* v. *National Labor Relations Board*, 344 U.S. 25, 29, 97 L. Ed. 23, 29.

It is the duty of the court and the trustee to see that the intent and purpose of the Bankruptcy Act is carried out. That has been done in this case.

In addition to the reasons stated by the Court of Appeals, the decision is also correct under the decision of this court in *United States* v. *Marxen*, 307 U.S. 200, 83 L.

Ed. 1222, which was the basis of the decision of the District Court in this case.

In the instant case the note which is the basis of this claim was assigned to the SBA subsequent to the adjudication in bankruptcy. This fact was stipulated (R. 34), and is acknowledged in the Statement in the Petition here (Petition 6).

The Marxen case was on a certified question:

> "Where, prior to the filing of a petition for an adjudication in bankruptcy of the maker of a promissory note payable to a bank, the Federal Housing Administrator, under the provisions of the National Housing Act, insured the payee bank against the nonpayment of the note by its maker, upon which note the maker became in default more than sixty days prior to said filing and adjudication, and upon demand of the insured bank made after the adjudication, the Federal Housing Administrator paid to the bank its claim arising from such default, and procured an assignment to the United States of the claim of the insured bank against the bankrupt, which claim had not been presented or proved in bankruptcy by the insured bank, and presented such claim in the name of the United States to the trustee in bankruptcy, having before him other allowed claims against the bankrupt, is such claim entitled to priority over such other claims under § 3466 of the Revised Statutes (31 U.S.C.A. § 191), by reason of the provisions of § 64 (b) (7) (11 U.S.C.A., § 104 (b) (7))?"

The court held:

> "We are of the view that §3466 is inapplicable to general claims in bankruptcy transferred to the United States, or to which it has become subrogated on payment, after the filing of the petition for the reason that the rights of creditors are fixed by the Bankruptcy Act as of the filing of the petition in bankruptcy."

In the present case there is no conflict of decisions. The court below made no innovations or inventions in deciding this case. It was determined on settled principles of law as enunciated by former decisions of this court. There are no questions of importance involved in this decision which have not been determined by this court. No purpose would be served by the granting of a writ of certiorari in this case.

Effect on Government Lending Activities.

Petitioner contends the decision below will have far reaching and severe detrimental effects on extensive government lending activities. This argument is based on the proposition that SBA business loans "are primarily extended to concerns whose insolvency is not unlikely. It argues that the decision has placed government agencies in a dilemma: Whether to alter the nature of the participation agreements to avoid the impact of the decision, a course it alleges would be highly undesirable; or to let the participation agreements remain unmodified and leave the money disbursed unprotected by any priority right. We submit that this is an argument which should be presented to the Congress and not to this court.

We also submit that the facts presented by this petition do not support the conclusion for which petitioner contends. While the petitioner sets forth total sums of money outstanding on participation loans there is no showing of losses or defaults on those loans. The importance of the question of priority rests solely upon petitioner's unsupported statement that SBA business loans are primarily extended to concerns whose insolvency is not unlikely. This statement is contrary to the provisions of the Small Business Act of 1953, and to the regulations currently in effect.

We have contended from the outset of this litigation that in the Small Business Act of 1953 Congress evidenced unmistakably its purpose to rely for obtaining payment of the government advances on other means than the priority provided for by § 3466 (*United States* v. *Guaranty Trust Company*, 280 U.S. 478, 78 L. Ed. 556).

In the *Guaranty Trust Case* the court found this purpose by virtue of the provisions of the Transportation Act by which "the giving of adequate security was either required or left to the discretion of the President"; and that "under § 210 no advance could be made, unless the Interstate Commerce Commission was satisfied that the earning power of the carrier and the security given furnished reasonable assurance that the loan would be repaid and all obligations in connection therewith would be performed."

So, in this case, the Small Business Act of 1953 provided:

> "No financial assistance shall be extended pursuant to (a) above unless the financial assistance applied for is not otherwise available on reasonable terms *and all loans made shall be of such sound value or so secured as reasonably to assure repayment*; no immediate participation may be purchased unless it is shown that a deferred participation is not available; and no loan may be made unless it is shown that a participation is not available." (Emphasis supplied) (15 U.S.C.A. 636 (a) (1)).

When the Small Business Act was re-enacted in 1958, the language emphasized above was made a separate subsection, so that 15 U.S.C. § 636 (a) now provides:

> "(7) All loans made under this subsection shall be of such sound value or so secured as reasonably to assure repayment."

Likewise, the regulations promulgated pursuant to that act provide:

> "(c) Emphasis shall be on the repayment ability of the borrower as determined from the record of past earnings.
>
> "(d) All loans shall be secured; however, the participating bank shall be responsibe for obtaining the pledge of collateral as well as determining the adequacy thereof. Security may include, but shall not be limited to, mortgage on real or personal property, assignment of accounts receivable or monies due on contracts, pledge of warehouse receipts and guaranties."
>
> 13 CFR § 120.4-. (c) (d), 23 F.R. 10513, December 31, 1958.

The reports of the SBA would indicate that these directions have been followed. During the consideration of H. R. 7963, which became public law 85-536, 72 Stat. 384, the Small Business Administration reported on its activity under the business loan program. The summary of this activity from the beginning of operation through the third quarter of fiscal year 1958 shows a total of 7,558 loans disbursed in a total amount of $336,527,024, of which SBA's share was $279,638,384. Through March 25, 1958, only 17 loans had been charged off at a loss of $166,912, of which $159,383 was principal and $7,529 was interest and other receivables. While it is also shown that on that same date 180 loans, of which SBA's share was $5,654,034, were in liquidation, a note concerning the loans in liquidation states, "It is anticipated that existing collateral will permit recovery of the greater portion of this unpaid principal balance." (These figures are tabulated in Senate Report No. 1714, June 16, 1958, to accompany H. R. 7963, under the heading Business Loans—Small Business Administration—Selected Statistics on Business Loans.)

Petitioner concludes that the decision below will seriously undermine these participation programs and will force the agencies to revise their participation agreements to avoid the decision. We submit that that is not the case. The Congress and the Small Business Administrator from the beginning of the Small Business Administration have shown the way. That is by placing emphasis upon the repayment ability of the borrower and making loans of such sound value or so secured as reasonably to assure repayment. The intent of Congress, as derived from an analysis of the Small Business Act of 1953, has never been to rely upon the priority granted to the United States for repayment of these loans.

The decision below is correct and petitioner has failed to show any special and important reasons for the court to grant a writ of certiorari in this case.

CONCLUSION.

For the foregoing reasons, it is respectfully submitted that this petition for writ of certiorari should be denied.

Respectfully submitted,

JOHN Q. ROYCE,
Salina, Kansas,
Attorney for Respondent.

No. 42

In the Supreme Court of the United States

OCTOBER TERM, 1960

SMALL BUSINESS ADMINISTRATION, PETITIONER

v.

G. M. McCLELLAN, TRUSTEE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE SMALL BUSINESS ADMINISTRATION

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ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE SMALL BUSINESS ADMINISTRATION

OPINIONS BELOW

The opinion of the United States District Court for the District of Kansas (R. 38–43) is reported at 168 F. Supp. 483. The opinion of the United States Court of Appeals for the Tenth Circuit (R. 45–49) is reported at 272 F. 2d 143.

JURISDICTION

The judgment of the court of appeals was entered on November 6, 1959 (R. 50). On January 25, 1960, Mr. Justice Whittaker entered an order extending the time to file a petition for a writ of certiorari to and including February 24, 1960 (R. 50). The petition for certiorari was filed on February 24, 1960, and

granted on April 18, 1960 (R. 51), 362 U.S. 947. The jurisdiction of this Court rests upon 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether, where an agency of the United States participates with a private financial institution in making a loan, the agency must be denied the debt priority granted the United States by R.S. § 3466, 31 U.S.C. 191, solely because, by virtue of the participation agreement between the two, the private institution will share ratably in any amounts recovered on the loan by the Government agency.

2. Whether, by purchasing a 75% "participation" in a loan made by a bank to a borrower, the Small Business Administration became the owner of a 75% interest in the debt, so that there was then a debt due to the Administration from the borrower.

3. Whether debts due to the Small Business Administration are "debts due to the United States" within the meaning of R.S. § 3466.

4. Whether the Small Business Act excepted loans made under it from the priority granted by R.S. § 3466.

STATUTES INVOLVED

1. Section 64 of the Bankruptcy Act, as amended, 11 U.S.C. 104, provides in pertinent part:

> § 104. *Debts which have priority.*
>
> (a) The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be * * * (5) debts owing to any person, including the United

States, who by the laws of the United States i[s] entitled to priority * * *.

2. Section 3466 of the Revised Statutes, 31 U.S.C. 191, provides:

> § 191. *Priority established.*
>
> Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed.

STATEMENT

This suit was brought by the Small Business Administration, a non-incorporated agency of the United States, to review the order of a referee in bankruptcy denying the S.B.A.'s claim to priority on a debt owing from the bankrupt.

1. On October 8, 1956, S. H. Byquist submitted an application for a $20,000 loan to the Brookville State Bank (hereafter "Bank") of Brookville, Kansas (R. 15–24). The application was made on an S.B.A. form headed "Limited Loan Participation Application for Loan" (R. 15), and contained two credit reports labeled "For Use of Small Business Administration only" (R. 19–22). In the applica-

tion the borrower agreed that "In consideration of the making by SBA to applicant of all or any part of the loan applied for in this application, applicant hereby agrees with SBA that applicant will not, for a period of two years after disbursement by SBA to applicant of said loan," employ any person who worked for S.B.A. on the date of disbursement or within one year prior to that date (R. 22). The application also stated that "All information contained [in the application is] submitted for the purpose of inducing SBA to grant a loan, or to participate in a loan by a bank or other lending institution, to applicant" (R. 23). On October 30, 1956, the Bank endorsed Byquist's application, indicating that it would make the loan requested, but only on condition that the S.B.A. participate in the loan immediately to the extent of 75 percent, that is, $15,000 (R. 24).

On November 2, 1956, the Administrator authorized the S.B.A. to enter into a "Participation Agreement" with the Bank for the purchase from the Bank of an immediate 75 percent participation in the loan to be made to Byquist (R. 24–26). The same day, Byquist was advised that the S.B.A. had approved his application for an immediate participation loan (R. 29). The Participation Agreement was signed by the Bank and sent to the S.B.A. on November 16, 1956, and was signed and dated by the S.B.A. on November 19, 1956 (R. 27–28). The Agreement provided, *inter alia,* that the S.B.A. would, upon written demand by the Bank, purchase from the Bank a 75 percent participation of each disbursement made to

the borrower (R. 4); that the Bank would hold the note, but that it would transfer the note to S.B.A. within five days if S.B.A. should make a written demand therefor (R. 8); and that neither party to the agreement could, without the prior consent of the other, make or consent to any alteration in the terms of the note or sue upon the note (R. 8).

In addition, the Agreement contained the following provisions (R. 8–9):

> 12. ADMINISTRATION OF LOAN.—The holder of the Note shall receive all payments on account of principal of, or interest on, the Loan and promptly remit to the other party its pro rata share thereof determined according to their respective interests in the Loan * * *.
>
> * * * * * *
>
> 14. LIABILITY AND REPRESENTATIONS.—* * * neither party shall be liable to the other for any loss, not due to its own gross negligence, but such loss, shall be borne ratably by S.B.A. and Bank in accordance with their respective interests in the Loan.

In compliance with the agreement and upon demand of the Bank, the S.B.A. sent a check for $15,000, dated November 23, 1956, and drawn on the Treasurer of the United States, to the Bank for the sole purpose of purchasing a 75 percent interest in the loan to Byquist (R. 15, 28). The Bank's right to accept and negotiate the check was expressly conditioned on the Bank's execution and delivery to S.B.A. of a Participation Certificate (S.B.A. Form 152) as evidence of the purchase by S.B.A. of its interest in the loan (R. 28).

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The Bank then disbursed the loan of $20,000 to Byquist (R. 31, 39) and executed and delivered to the S.B.A. the required Participation Certificate.[1]

The loan was evidenced by a note, dated November 16, 1956, to the order of the Bank (R. 9–13). The note was on another S.B.A. form and was headed "NOTE (For Limited Loan Participation Only)" (R. 9). In the note, the borrower covenanted, *inter alia,* to use the proceeds of the loan solely for the purposes set forth in the S.B.A.'s loan authorization, and to reimburse "Holder and S.B.A., respectively," for expenses incurred by them in connection with this loan (R. 11).

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[1] The executed Participation Certificate (S.B.A. Form 152) is not in the record, but its execution by the Bank is not questioned. For the sake of completeness, the text of the certificate is printed below:

PARTICIPATION CERTIFICATE

Brookville State Bank (hereinafter called "Bank"), hereby certifies that Small Business Administration (hereinafter called "SBA") has purchased from Bank a participation of 75% of $20,000.00, representing the amount of the disbursement, or the aggregate amount of the disbursements (as the case may be) made by Bank on the 23rd day of November 1956, and remaining unpaid on the date of such purchase, on account of a loan by Bank to S. H. Byquist, d/b/a Western Distributors, Salina, Kansas, in an amount not exceeding $20,000.00, such purchase having been made pursuant to a Participation Agreement dated November 19, 1956, between SBA and Bank.

Dated: November 23, 1956

By [S] Brookville State Bank (Bank)
R. D. Powers
Cashier (Title)
Brookville, Kansas (Address)

2. An involuntary petition in bankruptcy was filed with respect to Byquist on August 17, 1957, and he was adjudged a bankrupt on September 5, 1957 (R. 38). On October 22, 1957, a trustee was appointed (R. 38). He proceeded with the liquidation of the estate and holds a sum somewhat in excess of $19,000 (R. 32, 38). Claims totaling $43,682.07 have been filed, and the cost of administration has been estimated at $6,500.00 by the trustee (R. 32).

After the filing of the petition in bankruptcy, the Bank transferred Byquist's note to the S.B.A. (R. 32). The S.B.A., on behalf of the United States, filed a priority claim in the bankruptcy proceedings under Section 64 of the Bankruptcy Act, 11 U.S.C. 104, *supra*, p. 2, which provides that "debts owing to any person, including the United States, who by the laws of the United States, i[s] entitled to priority" are accorded a fifth priority in bankruptcy. The S.B.A. claimed such priority "by the laws of the United States" over the other unsecured creditors by virtue of R.S. § 3466, 31 U.S.C. 191, *supra*, p. 3, which provides that "debts due to the United States shall be first satisfied" out of the estate of an insolvent debtor. The S.B.A. filed a claim for the sum of $16,355.69[2] representing the entire amount still unpaid on the note, with interest through October 15, 1957 (R. 2–3). Recognizing, however, that 25 percent of that claim represents an amount owed by the bankrupt to the Bank, the Government has, through-

[2] As originally filed, the claim was for $16,788.42, but it was later stipulated that the correct figure, after all credits, was $16,355.69 (R. 34).

out these proceedings, in fact claimed priority only for $12,266.77, its 75 percent interest in the debt (R. 34).

On objections by the trustee (respondent here) to the claimed priority, the referee in bankruptcy denied priority to the S.B.A.'s claim on the ground that the S.B.A. is an independent agency not entitled to the debt priority accorded to the United States by R.S. §3466 (R. 33–36). The claim was thus allowed only as a non-priority, unsecured claim (R. 35–36).

3. After denial of its claim for priority, the S.B.A. filed a petition for review in the United States District Court for the District of Kansas. The district court rejected the referee's conclusion that the S.B.A. could not claim the debt priority accorded to the United States, but, nevertheless, affirmed the referee's order on the ground that there was no debt running from the bankrupt to the S.B.A. until assignment of the note to the S.B.A., subsequent to the date of bankruptcy (R. 38–43). In support of its decision, the court pointed out, *inter alia,* that the note executed

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[3] The $12,266.77 sought by the S.B.A., and for which priority is here asserted, represents the extent to which the S.B.A.'s $15,000 participation in the loan remains unpaid. Since the Bank's 25 percent interest in the debt was assigned to the S.B.A. subsequent to the date of bankruptcy, that portion of the debt remained, for bankruptcy purposes, a claim of the Bank. While the court of appeals' opinion does not indicate that the Government's priority claim was for only $12,266.77, the amount due it, and not for the $16,355.69 owing on the entire loan, this fact was made clear by the Government throughout the proceedings. The court of appeals failed to make this plain in its opinion presumably because, in view of its reasoning, the amount for which the S.B.A. was claiming priority was irrelevant.

by the bankrupt was made payable to the Bank only, that the S.B.A. paid its $15,000 share of the loan to the Bank, and that the Bank paid the full amount of the loan to the bankrupt (R. 42). Accordingly, the court held that, since under *United States* v. *Marxen*, 307 U.S. 200, the status of a claim against a bankrupt's estate is determined on the date the petition is filed, and since an assignment after that date cannot give an assignee any greater rights than those of his assignor, the S.B.A.'s claim to priority must be denied (R. 42–43).

On appeal by the S.B.A., the Court of Appeals for the Tenth Circuit affirmed, but on still another ground (R. 45–49). The court assumed, *arguendo*, both that the Small Business Administration is entitled to the statutory priority granted the United States (R. 47), and that, by virtue of its immediate participation in the loan, the Small Business Administration became beneficial owner of a 75 percent interest in the debt prior to the filing of the petition in bankruptcy (R. 47–48). The court held, however, that the S.B.A. could not assert a priority for the amount owing to it because, in its participation agreement with the bank, it had agreed to share ratably the proceeds and losses resulting from the transaction with the borrower. The court stated (R. 49):

> In *Nathanson* v. *National Labor Relations Board*, 344 U.S. 25, 28, it was said that § 3466 may not be extended to create a priority for a claim which the United States is collecting for a private party. This principle would be violated if the claim of the United States were here given priority.

> The United States is bound by its written contract to account to the Bank for the Bank's 25% share of any collection made under the note. Hence, the Bank would share to that extent in any proceeds resulting from the award of a priority to the United States. * * *
>
> * * * * * *
>
> * * * [The United States] may not assert a priority which will produce a recovery that by contract must be divided with a private entity.

SUMMARY OF ARGUMENT

The basic question in this case is whether the claim of the United States which was filed by the S.B.A. in the bankruptcy proceeding is entitled to priority over the claims of other unsecured creditors. Under Section 64 of the Bankruptcy Act, 11 U.S.C. 104, *supra*, "debts owing to any person, including the United States, who by laws of the United States, i[s] entitled to priority" are accorded a fifth priority. If the S.B.A. were given that priority here, its claim would take precedence over the claims of the other unsecured creditors. It is our contention that the S.B.A. is entitled to such priority under R.S. § 3466, which provides that "debts due to the United States shall be first satisfied" out of the estate of an insolvent debtor.

I

The court below erred in holding that the S.B.A. cannot claim a debt priority here with respect to the amount owed to it by the bankrupt because, by contract, it is bound to remit to the participating bank the latter's pro rata share of all amounts collected

on the debt. While it is settled that the United States may not invoke its priority right so as to collect a debt owing to a private party, this principle is inapplicable in the present case because the S.B.A. is asserting priority for a claim owned by it alone.

What the S.B.A. has contracted to do with its priority recovery is not properly relevant to the question of whether it is entitled to a priority. The S.B.A.'s outside contractual arrangements cannot affect the bankruptcy rights of the other creditors and do not interfere with the scheme of distribution of the Bankruptcy Act.

In addition, important policy considerations pertaining specifically to the objectives of the Small Business Act strongly favor allowance of the priority sought here by the S.B.A.

II

The claim for which the S.B.A. asserts priority constituted a debt due the United States on the date of the filing of the petition in bankruptcy. While the note evidencing the debt was payable to the order of the participating bank and was formally assigned to the S.B.A. only after the bankruptcy, the S.B.A. was beneficial owner of a 75% interest in the debt from the time that it purchased a 75% "participation" in the loan, long before the date of bankruptcy.

In response to the Bank's written demand, the S.B.A. sent the Bank a Treasury check for the sole purpose of purchasing an undivided 75% share in the loan to the bankrupt. The Bank accepted the

S.B.A.'s check, disbursed the loan, and sent the S.B.A. a Participation Certificate certifying that the S.B.A. had purchased a portion of the loan. Nothing more was needed to make the S.B.A. the owner of 75% of the debt from the bankrupt. The promissory note tendered by the bankrupt could have been demanded at any time by S.B.A. The note, in any event, constituted merely the evidence of the debt since its transfer to one or the other of the participating parties could not alter their respective interests in the actual debt.

III

Debts due the S.B.A. are clearly "debts due to the United States" within the meaning of R.S. § 3466. The S.B.A. is an unincorporated agency of the United States Government which, in carrying on its statutory operations, administers and lends funds originating from Congressional appropriations. It is settled that such an agency must be regarded as the United States for the purposes of R.S. § 3466.

IV

There is no language in the Small Business Act which expressly denies the S.B.A. the priority granted by R.S. § 3466, nor is the S.B.A.'s assertion of the priority right basically inconsistent with the objectives sought to be achieved by the Small Business Act. Indeed, the legislative history of the 1958 amendments

to the Small Business Act of 1953 shows full Congressional acceptance of the view that the S.B.A. is entitled to the benefits of R.S. § 3466.

ARGUMENT

The preference, in the public good, of debts due the United States over private debts is a policy dating back to the beginning of the nation[4] and one to which this Court, repeatedly reminding the lower courts that R.S. § 3466 must be liberally construed,[5] has given full effect. The several decisions below, each seizing upon a different technical ground to defeat the S.B.A.'s priority, are, we believe, inconsistent with that policy and unsupportable even on a strict construction of R.S. § 3466.

Dealing first with the ground of the court of appeals' decision, we will show that the S.B.A.'s con-

[4] The statute is derived from early statutes enacted for the collection of taxes, and its provisions have been in force since 1797 without significant modification. See *Price* v. *United States*, 269 U.S. 492, 500–501; *United States* v. *Emory*, 314 U.S. 423, 428.

In bankruptcy proceedings, of course, while R.S. § 3466 is the source of the priority, it is § 64 of the Bankruptcy Act that governs its relative rank. Under that section, claims given priority by R.S. § 3466 are in the fifth priority rank. See *Guarantee Title & Trust Co.* v. *Title Guaranty & Surety Co.*, 224 U.S. 152; 3 Collier, *Bankruptcy*, ¶ 64.502 (14th ed. 1956).

[5] See *e.g.*, *United States* v. *State Bank of North Carolina*, 6 Pet. 29, 35; *Price* v. *United States*, 269 U.S. 492, 500; *United States* v. *Emory*, 314 U.S. 423, 426; *Bramwell* v. *U.S. Fidelity Co.*, 269 U.S. 483, 487; *Beaston* v. *Farmers' Bank*, 12 Pet. 102, 134.

tractual undertaking to share proceeds and losses with the Bank is irrelevant to, and cannot affect, the priority to which the debt due the S.B.A. is otherwise entitled (Point I). We will then show that, contrary to the decision of the district court, the debt to the S.B.A. arose prior to bankruptcy (Point II) and that, contrary to the referee's decision, debts due the S.B.A. are "debts due to the United States" within the meaning of R.S. § 3466 (Point III). We will deal finally with the one remaining contention of respondent that has not been adopted by any of the tribunals below and show that the Small Business Act neither expressly nor impliedly excepts loans made under it from the priority granted by R.S. § 3466 (Point IV).

I

THE PRIORITY OF THE DEBT DUE THE S.B.A. IS NOT AFFECTED BY THE AGREEMENT BETWEEN THE S.B.A. AND THE PARTICIPATING BANK TO SHARE THE PROCEEDS AND LOSSES ON THEIR RESPECTIVE INTERESTS IN THE LOAN

The court of appeals held that, even if the S.B.A. were otherwise entitled to priority on its $12,000 share of the total outstanding loan of $16,000,* it lost that right to priority when it entered into a contract with the Bank to share pro rata the proceeds and losses on their respective interests in the loan. The court reasoned that no priority could be allowed because the

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*The figures are rounded off for simplicity. The amount actually remaining unpaid was $16,355.69, of which the S.B.A.'s 75% share was $12,266.77 (R. 34).

Bank, by virtue of the contract, would share in its proceeds and, under *Nathanson* v. *NLRB*, 344 U.S. 25, the priority statute "may not be extended to create a priority for a claim which the United States is collecting for a private party" (R. 49).

We will show that priority has not in fact been asserted for any claim due a private party and that the nature of the claim for which priority is asserted—a debt beneficially owned by the United States—is not affected by the agreement between the S.B.A. and the Bank to pool the proceeds and losses on their respective claims; that the policies of the Small Business Act require that priority be given the S.B.A.'s share of participation loans; and, finally, that even if allowing the Bank to share in the proceeds of the S.B.A.'s priority would be inconsistent with the purposes of R.S. § 3466, total disallowance of the S.B.A.'s priority would not be the appropriate remedy.

A. THE SOLE CLAIM FOR WHICH PRIORITY IS ASSERTED IS A DEBT BENEFICIALLY OWNED BY THE S.B.A., THE NATURE OF WHICH IS NOT AFFECTED BY THE PARTICIPATION AGREEMENT

1. The nature of the claim for which priority is asserted here is totally different from that involved in *Nathanson*, and the principle of that case is inapplicable. In that case, the National Labor Relations Board, to remedy an unfair labor practice committed by an employer, had ordered the employer to reinstate certain employees with back pay. When the employer went into bankruptcy, the Board filed a claim for the back pay due the employees. Although

upholding the Board's right, because of its exclusive power to enforce its own orders, to enforce the claim for back pay, this Court held that the claim was not entitled to priority under R.S. § 3466, stating (344 U.S. at 27–28):

> We do not, however, agree with the lower court that this claim, enforceable by the Board, is a debt due the United States within the meaning of R.S. § 3466 * * *. The priority granted by that statute was designed "to secure an adequate revenue to sustain the public burthens and discharge the public debts." * * * There is no function here of assuring the public revenue. The beneficiaries of the claims are private persons * * *.
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> * * * * *
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> It is true that * * * [because of the status of Indians as wards of the United States, priority has been given to claims by the United States for Indian moneys]. We cannot extend that reasoning so as to give priority to a claim which the United States is collecting for the benefit of a private party.

The basis for the decision, in short, was that the United States had no beneficial interest in the claim and was acting solely as an enforcement agency to collect debts beneficially owing entirely to private parties.

The complete answer to the court's reliance on *Nathanson* is that here the only claim "which the United States is collecting for the benefit of a private party" is the $4,000 share of the loan that is beneficially owned by the Bank, and for that claim no priority has in fact been asserted. Giving full effect

to *Nathanson*, the S.B.A. limited its claim of priority to the $12,000 actually advanced by and not yet repaid to it, and that part of the debt admittedly is beneficially owing to the United States. The difference between *Nathanson* and this case, in short, is that in *Nathanson* the United States was not the beneficial owner of the debt for which priority was claimed while in this case it is.

2. It is true that if the S.B.A. recovers the $12,000 owing to it and the Bank fails to recover the $4,000 owing to it, the S.B.A. will be required, by virtue of its contract with the Bank, to share its proceeds with the Bank and thus absorb a part of the Bank's loss. If so, however, the S.B.A.'s contribution to the Bank will be at its own expense and not at the expense of other creditors, for to the same extent that the S.B.A. pays over a part of its proceeds to the Bank its own claim against the bankrupt will remain unsatisfied. The crucial fact is that there is a debt beneficially owing to the United States in the full amount of the claimed priority, and the way in which the S.B.A. and the Bank have agreed to account to each other for the proceeds of their respective claims against the bankrupt is a matter of concern only to the S.B.A. and the Bank.

The court of appeals suggests that to allow the priority here would be "to prefer the Bank over the other private creditors" (R. 49), but patently that is not so. The other creditors are in no way prejudiced or even affected by the contract between the S.B.A. and the Bank. The S.B.A. itself advanced, and is admittedly entitled to recover on its own behalf, the

full $12,000 for which priority is asserted. But for the coincidental agreement with the Bank, the $12,000 would admittedly be a prior claim against the estate, and the agreement has in no way increased or affected the amount of the claimed priority. The other creditors will receive precisely the same distribution they would have received had there been no such agreement. So also the Bank, on its $4,000 interest in the debt, will receive as a distribution from the estate precisely the same proportion of its claim as the other private creditors. Anything else the Bank realizes on its loan transaction it will receive, not as a claimant in the bankruptcy proceedings, but solely by virtue of its independent agreement with the United States and out of the United States' own recovery. The agreement, in short, may give the Bank an advantage over the United States that it would not otherwise have, but it gives it no advantage over, or at the expense of, the other creditors.

In terms of any "preference" given one common creditor over another, the case here is, in fact, no different from one in which one creditor of a bankrupt agrees with another—in order, for example, to induce the second to extend credit—that any recovery on the two claims will go first to the second creditor until his claim had been paid in full. Clearly that independent agreement between the two creditors would afford no basis for disallowing the first creditor's claim on the ground that to allow it would be to prefer the second. So long as the second creditor's advantage is solely at the expense of the first creditor and the agreement between them does not prejudice

the other creditors, their private arrangements for sharing the proceeds of their claims is of no concern to the bankruptcy court.

3. We may note, finally, that even if the contractual arrangements between the S.B.A. and the Bank were to be taken into account in determining the priority to be allowed, the result would not necessarily be, as respondent assumes, to reduce the allowable priority to zero. Starting with a debt due the S.B.A., and presumptively entitled to priority, of $12,000, respondent argues that, since $3,000 of that would have to be paid over to the Bank, only the $9,000 that would remain with the S.B.A. should be entitled to priority. As respondent points out, however, that would not solve the problem, for 25% of a $9,000 distribution would in turn have to be paid over to the Bank, leaving the S.B.A. with only $6,750, and so on ad infinitum, from which respondent concludes that the only solution is to disallow the S.B.A.'s priority in toto (Br. in Opp. 10–11).

It can be said with equal plausibility, however, that the progression works the other way, for with each payment over to the Bank there remains a "debt due to the United States" which has not yet been satisfied and which, presumably, is therefore entitled to priority. There is initially a debt due the United States of $12,000, which R.S. § 3466 requires "shall be first satisfied" before other debts are paid. If the participation agreement is taken into account, however, it is clear that a distribution of only $12,000 would, after payment of 25% to the Bank, still leave an "unsatisfied" debt due the United States of $3,000.

If debts due the United States are to be "first satisfied", a further distribution of $3,000 would be required, which in turn would still leave unsatisfied a debt of $750, and so on ad infinitum. The solution to that problem, of course, would be to give the S.B.A. a priority for the full $16,000 loan to begin with, so that its $12,000 debt will be fully "satisfied" before payment of other creditors.

The point is that, if, as respondent insists, the participation agreement must be taken into account, it can lead as readily to a conclusion that a $16,000 priority should be allowed as to a conclusion that no priority should be allowed. There is no more reason, *a priori,* to deny the S.B.A.'s priority altogether to make sure the Bank gets nothing than there is to give a $16,000 priority to make sure that the S.B.A. gets its full $12,000. The proper answer we think is that what the S.B.A. and the Bank have agreed between themselves to do with their recoveries can neither augment nor diminish their rights against the estate, which turn instead solely upon the debts owed to them individually by the bankrupt.

In sum, the teaching of the *Nathanson* case is that the United States may not invoke its priority right so as to gain priority for a claim actually owned by a private person. That teaching is inapplicable here because the S.B.A.'s assertion of priority is solely for a claim entirely its own, a claim which arose from a loan made by the S.B.A. to the bankrupt. What the S.B.A. has contracted to do with its recovery from the bankruptcy proceeding is irrelevant to the determination of rights in that proceeding, just as are the out-

side contractual obligations of the other bankruptcy creditors. Nor can allowance of the priority claim here in any way interfere with the policy of equitable distribution of the Bankruptcy Act, since the other bankruptcy creditors would be entitled to recover no more if the S.B.A. had no contractual arrangement with the Bank. We submit, therefore, that there is nothing in the participation agreement justifying an exception to "the operation of so clear a command as that of § 3466." *United States* v. *Emory*, 314 U.S. 423, 433.

B. THE POLICIES UNDERLYING THE SMALL BUSINESS ACT REQUIRE THAT THE S.B.A.'S CLAIM BE ACCORDED PRIORITY

As already noted, it is our basic position that the S.B.A. is entitled to priority on its share of the loan under the settled principles traditionally applied by this Court in interpreting R.S. § 3466. In addition, however, we believe there are important policy considerations which reenforce the conclusion that the S.B.A. is entitled to priority here. Indeed, if the purposes of the Small Business Act are to be achieved fully, it is essential that the S.B.A. have a right of priority to aid it in recovering the funds disbursed by it in participation loans.

In enacting the Small Business Act of 1953, Congress expressly noted that the security and economic well-being of the Nation depended on the development and encouragement of small business enterprises. Sec. 202, 67 Stat. 232; 15 U.S.C. 631.[7] To that end,

[7] After several amendments, the Act was reenacted in 1958. 72 Stat. 384, 15 U.S.C. 631–651. All the sections of the 1953 Act cited in this brief have been reenacted in virtually iden-

Congress created the Small Business Administration and authorized it to make loans, with funds derived from Congressional appropriations, to small business concerns, "either directly or in cooperation with banks or other lending institutions through agreements to participate on an immediate or deferred basis." Sec. 207(a), 67 Stat. 236; 15 U.S.C. 636(a). It was further provided, however, that (Sec. 207(a)(1), 67 Stat. 236; 15 U.S.C. 636(a)(2)):

> * * * no immediate participation may be purchased unless it is shown that a deferred participation is not available; and no loan may be made unless it is shown that a participation is not available * * *.

Since the statutory scheme thus contemplates that private loan aid is to be enlisted by the S.B.A. to whatever extent it is available, loans made by the S.B.A. in participation with private institutions have constituted the bulk of the S.B.A.'s business loan program, and will continue to do so.[8] The success of such a participation program depends entirely, of course, on the willingness of private lending institutions to join in the program offered by the Government agency and to assume thereby a portion of the attendant risks.[9] The possibility of being indemnified, at least in part, by the United States,

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tical form in the 1958 Act, and all U.S. Code references are for convenience given to the 1958 edition of the Code.

[8] See statistics in Petition for a Writ of Certiorari, pp. 14–15.

[9] These risks are, of course, not insubstantial. In view of statutory prerequisites as to their availability, S.B.A. loans are often extended to concerns whose insolvency is not unlikely.

which is more likely to collect its debts because of its right of priority, has provided a vital incentive for banks to take these risks and participate in the S.B.A.'s program. Recognition of the S.B.A.'s right to claim a debt priority (but, of course, solely with respect to that portion of the loan actually disbursed by it) and to then remit, pursuant to contract, a share of that priority recovery to the participating bank, is, we believe, essential to safeguard this incentive feature of the Congressionally devised participation program and, by the same token, vital to the program's success.

In contrast, the view adopted by the court below would seriously impair the S.B.A. program by rendering it far less attractive to prospective bank participants. Under that decision, the S.B.A. would be required, in order to avoid forfeiting its right of priority for moneys advanced by it, to revise its participation agreements to limit the sharing provisions to non-priority proceeds. There are, we think, few lenders who would be willing to participate on such terms—namely, being full partners in advancing the money but not in sharing the proceeds.[10] That, we submit, is a strong reason for allowing the priority here, for the "established rule of liberal construction requires that the priority act be applied having regard to the public good it

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[10] See also Petition for a Writ of Certiorari, p. 16; 108 U. Pa. L. Rev. 909, 914 (1960).

As we pointed out in our petition for certiorari, the contractual provision relating to the pro rata sharing of gains and losses is also in common use in various other Government participation loan programs.

was intended to advance." *Bramwell* v. *U.S. Fidelity Co.*, 269 U.S. 483, 492.

Another important factor is that the decision below, by denying the S.B.A. a right of priority on all sums advanced by it under its present participation program, may well have the effect of making a small business's creditors eager to force the business into bankruptcy immediately after it receives an S.B.A. loan in order to reap a benefit from the loan funds. To that extent, instead of aiding and encouraging the continued operation of a small business, the S.B.A. loan would hasten its demise.[11] On the other hand, if the S.B.A. were allowed priority on its advances, creditors would have nothing to gain from an immediate bankruptcy, and the loan's purpose—to stimulate confidence in the business and to enable it to continue functioning—would more likely be served. Similarly, under the Tenth Circuit's view, creditors will be tempted to induce small businesses to obtain S.B.A. participation loans merely for the creditors' benefit in the event of bankruptcy. Such a purpose in securing a loan would not fulfill any of the objectives of the Act and, indeed, is contrary to the S.B.A.'s regulations. 13 C.F.R. 120.4–2(d)(1)(i).[12]

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[11] These consequences of a holding that the S.B.A. cannot claim priority on its participation loans would be harmful to the S.B.A.'s program under any circumstances. However, in times of economic depression they would be particularly grave. S.B.A. loans would be the only source of credit available to many small businesses, but the making of an S.B.A. loan would serve primarily as an incentive to the business's private creditors to recover what funds they could by an immediate bankruptcy proceeding.

[12] Furthermore, in many situations it will be obviously unjust

C. IF ALLOWING THE BANK TO SHARE THE PROCEEDS OF THE PRIORITY WOULD BE INCONSISTENT WITH THE PURPOSES OF R.S. § 3466, THE APPROPRIATE REMEDY WOULD BE FOR AN APPROPRIATE COURT TO DENY THE BANK'S PARTICIPATION RATHER THAN TO DISALLOW THE S.B.A.'S PRIORITY IN ITS ENTIRETY

We have thus far sought to show that what the S.B.A. proposes, or has obligated itself, to do with the proceeds of its priority are of no concern in determining its rights to the priority. We will now show, however, that even accepting the court of appeals' view that no priority can be allowed which would result in a benefit to the Bank, it would not follow that the proper remedy is to disallow the priority in its entirety. Rather, we submit, the proper remedy in that case would be for an appropriate court to deny enforcement of the Bank's right to share in the proceeds attributable to the priority.

The court of appeals, having concluded that it would be inconsistent with the purposes of R.S. § 3466 to allow a priority which would benefit the Bank, apparently believed that it was faced with a dilemma. If it allowed the priority, the Bank would be benefitted, thereby violating the assumed limitation on R.S. § 3466. If it denied the priority, the United States

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to deny the S.B.A. priority on its debt claim in bankruptcy because the proceeds of the S.B.A.'s loan funds will comprise the bulk of the bankruptcy estate. S.B.A. participation loans, by necessity, go to small businesses that cannot get credit from other sources. When such a business goes into bankruptcy, its remaining funds will often be traceable to the S.B.A. loan. Thus, it may not be a coincidence that, in the case at bar, a $20,000 participation loan was extended, and $19,000 is the amount in the trustee's hands—particularly since the involuntary petition in bankruptcy was filed less than a year after the loan was made.

would not be assured payment of the debt admittedly due it, thereby frustrating the primary purpose of R.S. § 3466. Faced with that choice, the court presumably concluded that the policy of precluding a private benefit was more compelling than that of assuring the public benefit, and so held that the S.B.A.'s right to prior payment must be sacrificed to prevent any benefit accruing to the Bank.

Even accepting the court's view on the merits, it was not, we think, forced to that choice, for there was another remedy that would avoid both the assumed evil of allowing the Bank to participate and the frustration of R.S. § 3466 by denying the S.B.A. its priority—namely, granting the S.B.A. priority on its claim but recognizing that enforcement of the sharing agreement to the extent that it purports to apply to priority proceeds would be subject to attack in an appropriate proceeding. The result of the court of appeals' view is that the agreement to share priority proceeds is itself invalid, or at least impossible of performance, and if that is so it is difficult to see why denying enforcement of that agreement would not be a fully appropriate remedy. That remedy would be no more burdensome to the Bank than disallowing the priority entirely,[13] would avoid the collateral con-

[13] One slight adjustment might be required to avoid prejudicing the Bank—namely, requiring the United States to pay over to the Bank out of its recovery the amount by which the Bank's participation in the estate as a common creditor would have been augmented by a disallowance of the S.B.A.'s priority. Even assuming that the Bank is not entitled to the *benefit* of the S.B.A.'s priority, it would seem at least to be entitled by its agreement not to be *injured* by it—*i.e.*, not to have its participation in the estate diminished by the S.B.A.'s assertion of priority. With that adjustment, however, not even the

sequence of depriving the United States of the priority which it was the very purpose of R.S. § 3466 to give it; and would cause no disadvantage to the other creditors beyond that dictated by R.S. § 3466 itself.

The court of appeals' decision, on the other hand, produces drastic consequences wholly unrelated to the evil sought to be remedied. In authorizing participation agreements of the kind here involved, the Administrator clearly did not intend to waive the United States' right to priority (if, indeed, he was authorized to do so), and the effect of the decision below is to impose a forfeiture of the Government's priority rights on all the loans outstanding under such agreements merely because of a mistake of law by the Administrator in considering such agreements to be proper. In this case, for example, because the Administrator improperly (in the court's view) agreed to pay $3,000 of the priority proceeds over to the Bank, the United States is to be denied substantially all of its recovery on a $12,000 debt—a recovery that it was the very purpose of R.S. § 3466 to assure. Such a result might be justified if the other creditors had in some way been prejudiced by the sharing

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Bank could object to limiting the remedy to rejection of its participation rather than disallowing the S.B.A.'s priority in its entirety, for the result to it would be the same.

The effect of that adjustment, it may be noted, would be not to allow the Bank to participate in the priority but only to deny to the S.B.A. any priority *vis-à-vis* the Bank. That limitation on the S.B.A.'s priority is justified by the Bank's reliance upon its agreement of equal treatment in lending the money, and the other creditors would not be prejudiced since the adjustment would come out of the S.B.A.'s recovery.

agreement, but as we have shown above they have in no way been affected by the agreement and will receive the same distribution they would have received had the agreement not been made. Thus the result of the decision below is simply to give to the other creditors, at the expense of the United States, a windfall over what they could otherwise have expected to receive.

If, as R.S. § 3466 establishes, the public interest requires that debts due the United States be first satisfied, there can, we submit, be no justification for forfeiting that protection of the public interest in its entirety merely because a public official erroneously—though in good faith and without prejudice to other creditors—agreed to share a part of the proceeds of that priority with a private party. Particularly is that so where, as here, the result of so subordinating the public interest is not to compensate persons injured by the alleged error but simply to produce a windfall for persons in no way affected by it. We submit, accordingly, that if allowing the Bank to participate in the proceeds of the S.B.A.'s priority would offend the policy of R.S. § 3466 (which we deny), the appropriate remedy would be simply to test out the Bank's right to that participation in an appropriate case. There is no need at the same time to frustrate the primary purpose of that very statute by denying the United States priority on the debt due it.

We are of course aware that if that be the proper remedy, the objection of the trustee and the other creditors to the Bank's contractual participation in the proceeds of the S.B.A.'s claim, even if upheld,

would avail them nothing. That, however, goes only to emphasize our primary point that the agreement between the S.B.A. and the Bank to pool their proceeds and losses on the loan transaction does not affect the rights of, and is of no concern to, the other creditors and ought to be irrelevant to this proceeding.

II

A 75% INTEREST IN THE DEBT WAS OWNED BY THE S.B.A. BEFORE BANKRUPTCY

Although the court of appeals did not reach the question, the district court held that no debt was due the S.B.A. from the bankrupt until the Bank transferred the note to the S.B.A. after the bankruptcy petition had been filed, and hence that the S.B.A. was not entitled to priority (R. 42–43). We do not question that the rights are to be determined as of the date on which the petition in bankruptcy was filed (*United States* v. *Marxen*, 307 U.S. 200), but in our view it is clear that the S.B.A. acquired full ownership of 75% of the debt upon the initial purchase of its participation and that the possession of the note was immaterial.

1. The participation agreement entered into by the S.B.A. and the Bank before the loan was made provided that (par. 2, R. 4):

> SBA, upon written demand by Bank, will purchase from Bank a participation of 75 per cent of each disbursement made by Bank to Borrower on account of the Loan, immediately after such disbursement, for an amount of money equal to the amount of said participa-

> tion. Immediately upon each such purchase, Bank will execute and deliver to SBA a Participation Certificate on SBA Form 152 evidencing the interest in the Loan so purchased.

It was further provided that any security held by the Bank or the S.B.A. "shall secure the interests of both Bank and SBA in the Loan" (par. 6, R. 5); that neither party would "assign * * * its interest in the Loan" without the consent of the other (par. 7, R. 6); that the Bank would hold the note but upon written demand from the S.B.A. would "transfer" the note within five days to the S.B.A., receiving back a "Certificate of Interest" evidencing the Bank's retained interest (par. 11, R. 8); that the holder of the note "shall receive all payments on account of principal of, or interest on, the Loan and promptly remit to the other party its pro rata share thereof determined according to their respective interests in the Loan" (par. 12, R. 8); and that neither party made any "warranty" of the loan or assumed any liability to the other "for any loss, not due to its own gross negligence, but such loss, shall be borne ratably by SBA and Bank in accordance with their respective interests in the Loan" (par. 14, R. 9).

Pursuant to that agreement, the Bank promptly made demand on the S.B.A. to purchase a 75% participation in the $20,000 loan, the S.B.A. paid the Bank $15,000, and the Bank executed and delivered to the S.B.A. the required participation certificate reciting that the S.B.A. "has purchased from Bank a par-

ticipation of 75% of" the loan pursuant to the participation agreement (see Statement, *supra*, p. 6).[14]

From the terms of the participation agreement governing the purchase and its consequences, it is evident that what the S.B.A. "purchased" for its $15,000 was neither more nor less than an undivided ownership interest in 75% of the debt, the S.B.A. and the Bank thereby becoming tenants-in-common of the debt. All rights and liabilities of the parties thereafter were to be determined strictly "in accordance with their respective interests in the Loan" and any independent warranties or other liabilities from one to the other were expressly disavowed. The only rights that either party thereafter possessed were the rights arising out of its ownership of an interest in the loan—namely, to have the other party account to it, in accordance with its interest, for any proceeds of the loan. The participation agreement, indeed, seems to have done no more than to make express the usual

[14] While it seems to us unimportant, it may also be noted that the bankrupt was fully aware of the S.B.A.'s proposed participation in the loan from the outset. The loan application itself was made on an S.B.A. form and was, indeed, directed primarily to the S.B.A. (R. 15–24). So also, although it seems to us irrelevant whether the S.B.A.'s participation was purchased before or after disbursement of the loan, it may be noted that the participation agreement contemplated the S.B.A.'s immediate purchase of a 75% participation and that the loan was in fact not disbursed until after demand had been made on the S.B.A. and the S.B.A. had forwarded its check (though the check was not to be negotiated until the loan was actually disbursed) (see Statement, *supra*, pp. 3–6).

incidents of ownership that would arise upon the assignment by one party of an undivided interest in a debt to another. And, since the Bank undertook no independent obligations to the S.B.A., it is difficult to see what the S.B.A. did acquire if it was not an ownership interest in the debt.

We are unable to understand, then, how it can be said that the S.B.A. was not, after its purchase, the "owner" of 75% of the debt.[15] It is true that the parties agreed that the Bank should hold the note and collect the payments unless and until the S.B.A. requested transfer of the note to it. That, however, was not at all inconsistent with joint ownership, and the effect was simply to make the Bank the collection agent for the tenants-in-common until the S.B.A. should direct otherwise. Obviously the ownership rights obtained by an assignee of a claim are unaffected by his designation (here, in fact, a revocable designation) of the assignor as the collecting agent. See, *e.g., Hawley Down-Draft Furnace Co.,* 238 Fed. 122 (C.A. 3); *Cogan* v. *Conover Mfg. Co.,* 69 N.J. Eq. 809, 64 Atl. 973; 4 Corbin, *Contracts,* p. 522. Cf. *Rohr Aircraft Corp.* v. *County of San Diego,* 362 U.S. 628.

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[15] See *In re Westover, Inc.*, 82 F. 2d 177 (C.A. 2); *In re Prudence Bonds Corp.* 79 F. 2d 212 (C.A. 2); *Delatour* v. *Prudence Realization Corp.*, 167 F. 2d 621 (C.A. 2); *In re Prudence Co.*, 89 F. 2d 689 (C.A. 2), holding that the holders of participation certificates issued by a mortgagee evidencing participating interests in the mortgage and bond are creditors of the mortgagor, not of the mortgagee, so that their rights are not affected by the bankruptcy of the mortgagee. See also 108 Pa. L. Rev. 909, 913 (1960), commenting on this case.

Moreover, since, upon requesting transfer of the note to it, the S.B.A. was required to give the Bank a "Certificate of Interest" evidencing its retained interest in the debt and thereafter account to the Bank in the same way the Bank had accounted to it, it is clear that the transfer of the note itself had no effect upon the respective interests in the debt and amounted to no more than a mere transfer of possession and of the duty to act as the servicing agent. Clearly, therefore, the assignment to the S.B.A. of a 75% interest in the debt occurred, if it occurred at all, when it purchased that interest, evidenced by the participation certificate, and not when, after bankruptcy, the note was formally transferred to it. The note was simply the evidence of the whole debt which the Bank and the S.B.A. owned in common and was to be held by one party or the other as suited their convenience, the possession of the note having no effect on their underlying interests.

Whether or not the S.B.A. could have maintained a suit on the debt in its own name without first obtaining possession of the note—apparently thought crucial by the district court (R. 42)—seems to us irrelevant. The right to priority under R.S. § 3466 turns, not on the agency through whom collections are made, but solely on the beneficial ownership of the debt—a proposition which respondent would have been the first to endorse had the note been transferred to the S.B.A. before bankruptcy and the S.B.A. were here claiming priority for the Bank's interest in the debt as well as its own. See *Nathanson* v. *NLRB*, 344 U.S. 25; *United States* v. *Remund*, 330 U S. 539,

542.[16] In any event, since the S.B.A. had the right at any time to require the Bank to transfer the note to it on five days' notice, there was in fact no possible obstacle to the S.B.A.'s enforcing the debt at any time it chose.

2. The district court's decision is in no way supported by *United States* v. *Marxen*, 307 U.S. 200, upon which it relies. In that case, the Federal Housing Administration had insured a loan on which the borrower defaulted prior to bankruptcy, thereby precipitating the F.H.A.'s obligation to make payment of its guaranty. The guaranty was not in fact paid, however, until after bankruptcy. This Court held that the F.H.A. had not become subrogated to the bank's claim against the bankrupt until actual payment of the guaranty, and hence that there was no existing debt due the F.H.A. from the bankrupt at the date of bankruptcy. That decision, it seems to us, is of no help to respondent here since the S.B.A. had in fact made payment and received an ownership interest in the debt long before bankruptcy.

More in point is the decision of the Tenth Circuit in *Reconstruction Finance Corp.* v. *Riverview State*

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[16] See also *Price* v. *United States*, 269 U.S. 492, 500 ("[The purpose of R.S. § 3466] is not to be defeated by unnecessarily restricting the application of the word 'debts' within a narrow or technical meaning."); *Lewis* v. *United States*, 92 U.S. 618, 621 ("A valid indebtedness is as effectual in one form as another. No discrimination is made by the statute."); *Beaston* v. *Farmers' Bank*, 12 Pet. 102, 134 ("All debtors to the United States, whatever their character, and by whatever mode bound, may be fairly included within the [statutory] language.").

Bank, 217 F. 2d 455, which involved an immediate participation agreement entered into by the R.F.C. almost identical to that involved here. The court held there that the ownership interest of the R.F.C. came into existence, for bankruptcy purposes, when the R.F.C. became legally committed to buy an immediate participation in the loan, even though actual payment was not made until after bankruptcy. This case is, of course, *a fortiori* to that, since both actual payment and delivery of the participation certificate took place before bankruptcy.

III

DEBTS DUE THE S.B.A. ARE "DEBTS DUE TO THE UNITED STATES" WITHIN THE MEANING OF R.S. § 3466

Although the referee held that the S.B.A. was not the "United States" within the meaning of R.S. § 3466 (R. 35), that argument (though not reached by the court of appeals) was fully answered by the district court (R. 40–42) and need be only briefly considered here.

It is now firmly established that a non-incorporated agency of the United States must be regarded as the United States for the purposes of R.S. § 3466. See *United States* v. *Remund,* 330 U.S. 539; *United States* v. *Emory,* 314 U.S. 423; and *Korman* v. *Federal Housing Administrator,* 113 F. 2d 743 (C.A.D.C.), holding that the Farm Credit Administration and the Federal Housing Administration were entitled to the priorities of the United States. Cf. *United States*

v. *McNinch*, 356 U.S. 595, 598. Structurally, the S.B.A., like those agencies, is a non-incorporated federal agency created by Congress. 67 Stat. 233, as amended, 15 U.S.C. 633. The Administrator is appointed by the President with the advice and consent of the Senate, and the powers of the agency are vested in him. 15 U.S.C. 633(b). The agency is charged with the administration and execution of various small business programs, and the monies upon which those operations are based have their origin in Congressional appropriations. 15 U.S.C. 633(c). The S.B.A., in short, is as much an agency of the United States as any other non-incorporated executive agency.

That status is not altered by the fact that the Administrator in carrying out his statutory duties is authorized in his official capacity to "sue and be sued in any court of record of a State having general jurisdiction, or in any United States district court, * * *." 15 U.S.C. 634(b)(1). Corporate status, whatever difference that might make, was not conferred thereby. The sole effect of the "sue and be sued" provision was to preclude the assertion of sovereign immunity in suits against the agency, and, as a matter of convenience, to permit the Administrator to appear in his official capacity to press the claims of the agency. Cf. *Korman* v. *Federal Housing Administrator*, 113 F. 2d 743 (C.A. D.C.); *In re Wilson*, 23 F. Supp. 236, 240 (N.D. Tex.).

IV

THE SMALL BUSINESS ACT NEITHER EXPRESSLY NOR IMPLIEDLY EXCEPTS LOANS MADE UNDER IT FROM THE PRIORITY GRANTED BY R.S. § 3466

There remains for consideration a final contention pressed by respondent throughout these proceedings, but which none of the tribunals below has adopted and the district court expressly rejected (R. 42)—namely, that even if R.S. § 3466 would in terms grant priority to the debt, the Small Business Act should be construed as excepting loans made under it from that priority.

The conclusion of the district court that there is nothing in the Small Business Act to indicate that Congress intended the S.B.A. to be treated differently from other administrative agencies which have been accorded priority is fully supported. This Court has repeatedly emphasized, in answer to similar arguments, that "Only the plainest inconsistency would warrant our finding an implied exception to the operation of so clear a command as that of § 3466." *United States* v. *Emory,* 314 U.S. 423, 433; *United States* v. *Remund,* 330 U.S. 539, 544–545; *Illinois* v. *United States,* 328 U.S. 8, 12; *Massachusetts* v. *United States,* 333 U.S. 611, 634. Accordingly, only in the presence of express language (*Mellon* v. *Michigan Trust Co.,* 271 U.S. 236) or of a basic inconsistency with the avowed purpose of a particular statute (*Cook County National Bank* v. *United States,* 107 U.S. 445; *United States* v. *Guaranty Trust Co.,* 280 U.S. 478) has this Court found a legislative intent to waive the priority

conferred on the United States and its agencies by R.S. § 3466.

There is of course nothing in the Small Business Act expressly denying priority to loans made under it, and respondent's argument must rest solely on its assertion that affording priority on such loans would be inconsistent with a claimed objective of the Small Business Act to enhance the general credit standing of small businesses, which credit would be impaired by the anticipation that, in the event of insolvency, the S.B.A.'s claim would be given priority. An identical argument was made to this Court in *United States* v. *Emory*, 314 U.S. 423, as a reason for not granting priority to a loan made pursuant to the National Housing Act. The Court found no evidence of a specific purpose to build up the general credit standing of the borrowers (p. 433), as distinguished from the simple and direct purpose of providing the funds needed for construction and thereby "to stimulate the building trades and to increase employment" (p. 430), and concluded (p. 431):

> Consequently, the argument against the application of § 3466 is reduced to this: Private persons in general are reluctant to extend credit when they know that in the event of the borrower's insolvency the claims of the United States will receive priority, and this circumstance is particularly undesirable in times of economic stress. In the first place, whatever may be the merits of the contention, it should be addressed to Congress and not to this Court. In the second place, the argument proves too much. If it is sound as applied to this kind of

a claim of the United States, it is equally sound as applied to all claims as to which the United States asserts priority under § 3466.

The argument was again rejected in *United States* v. *Remund*, 330 U.S. 539, involving emergency feed and crop loans made by the Farm Credit Administration. Although the loans were in fact given to farmers whose credit was impaired, their purpose, the Court observed (p. 543), was not to restore the farmers' credit status as such but simply to provide them with the money needed "to purchase feed and to plant crops" and which they were unable to obtain from other sources. Since giving priority to the loans "could in no way impair the aid which the farmers sought through these loans" (p. 544), the Court found no such basic inconsistency of purpose as would be necessary to find an implied exception to R.S. § 3466.

Like the Federal Housing Act and the farm credit statutes, the Small Business Act is primarily concerned, not with building up the credit status of particular businesses as such (*i.e.*, to make them attractive as investments to other lenders), but simply to supply the funds immediately needed by them for the conduct of their business and which are not available from other sources—a purpose necessarily implicit in the requirement that private sources of loans be utilized to the extent they are available. That is, it was the immediate financial needs of small businesses, not the protection of their creditors, with which Congress was concerned. And just as in *Emory* the ultimate purpose was to bolster the national economy, so the preamble of the Small Business Act (15 U.S.C.

631(a)) makes clear that that was the ultimate purpose of granting economic aid to small businesses. In short, we submit, giving priority to such loans in the event of bankruptcy in no way impairs the value of the loan to a small business needing funds for its immediate operations (here, as working capital) which it cannot otherwise obtain, and thus in no way frustrates the purpose of the Small Business Act.

The essence of this Court's repeated view that exceptions to R.S. § 3466 are to be inferred only on a showing of irreconcilable conflict between that statute and another is that the judgment whether other purposes will be so seriously impaired as to justify a waiver of priority is one for Congress to make rather than the courts. Congress, in turn, has been fully aware of its responsibility and on occasion, when the matter has been presented to it and it has found the claims justified, has expressly waived the right of priority. It did so, for example, by an amendment to the Reconstruction Finance Corporation Act when, after loans under it had been held entitled to priority, it was found that giving priority to such loans was unduly prejudicial to other creditors. Act of May 25, 1948, 62 Stat. 261; see *In re Temple*, 174 F. 2d 145 (C.A. 7). That express waiver of priority for loans made by the R.F.C. is particularly significant here, since the very Act that created the S.B.A. also provided for the liquidation of the R.F.C. Act of July 30, 1953, 67 Stat. 230. Had Congress, having expressly and only recently denied priority to the R.F.C., intended similarly to deny priority to the S.B.A., it presumably would have said so.

Finally, any doubt that Congress did not intend to deny priority to loans under the Small Business Act is, we submit, removed by the legislative history of the 1958 amendments to that Act. Act of July 18, 1958, 72 Stat. 384. One of the proposed amendments considered in the Senate hearings was a proposal by Senator Payne that no debt due the S.B.A. should be entitled to the priority available to the United States under R.S. § 3466. See S. 3319, 85th Cong., 2d Sess. When introducing that bill, Senator Payne indicated that its purpose was to prevent claims of S.B.A. from taking precedence over state and local tax debts. 104 Cong. Rec. 2470. While the S.B.A. agreed that it should not be entitled to such priority over state and local tax liens, it opposed S. 3319 because it believed that the bill would prevent the S.B.A. from claiming priority even over non-governmental claims, as here. See *Hearing before the Subcommittee on Small Business of the Senate Committee on Banking and Currency with respect to the Credit Needs of Small Business,* 85th Cong., 2d Sess., pt. 2, p. 553. In deference to the views of the S.B.A., an amendment was adopted which provided only that any interest the S.B.A. held as security for a loan was to be subordinated to state and local tax liens to the same extent that it would be under state law if a private party held that interest. 72 Stat. 396, 15 U.S.C. 646. Significantly, the broad proposal to deny all priority to the S.B.A. was not adopted. Those actions demonstrate conclusively Congressional acceptance of the administrative view that the S.B.A. was entitled to

R.S. § 3466 priority under the Small Business Act as passed in 1953. See S. Rep. No. 1714, 85th Cong., 2d Sess., p. 10.[17]

CONCLUSION

For the foregoing reasons, we respectfully submit that the judgment of the court of appeals should be reversed.

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AUGUST 1960.

[17] See also 108 U. Pa. L. Rev. 909, 912 (1960).

U.S. GOVERNMENT PRINTING OFFICE 1960

FILE COPY

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1960.

No. 42.

SMALL BUSINESS ADMINISTRATION,
Petitioner,

vs.

G. M. McCLELLAN, Trustee,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS, TENTH CIRCUIT.

BRIEF FOR RESPONDENT.

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BRIEF FOR RESPONDENT.

OPINIONS BELOW.

This proceeding originated in bankruptcy in the United States District Court for the District of Kansas. The first decision was made by the Honorable E. R. Sloan, Referee in Bankruptcy. That opinion is unreported, but is contained in the record at pages 33 through 36. The opinion of the United States District Court for the District of Kansas, on petition for review, is reported at 168 F. Supp.

483, and appears in the record at pages 38 through 43. The opinion of the United States Court of Appeals for the Tenth Circuit is reported in 272 F.2d 143, and appears in the record at pages 45 through 49.

JURISDICTION.

The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1). The jurisdictional requisites are set forth in the brief of petitioner.

STATUTES INVOLVED.

The statutes involved are:

1. Section 64, Fifth, 11 U.S.C. §104(5) of the Bankruptcy Act which provides:

> "(a) The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be * * * (5) debts owing to any person, including the United States, who by the laws of the United States is entitled to priority * * *."

2. R.S. §3466 (31 U.S.C. §191) which provides:

> "Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed."

QUESTIONS PRESENTED.

The question for determination is whether or not the Small Business Administration, under the facts of this case, and the Small Business Act of 1953, is entitled to priority as to 75% of the unpaid portion of a note executed by a bankrupt to the Brookville State Bank. This raises the following subsidiary questions:

1. Whether or not the allowance of the priority would be inconsistent with other statutes and acts of Congress.

2. Whether or not there was a debt due to the Small Business Administration or the United States at the date of bankruptcy.

3. Whether or not debts due to the Small Business Administration are "debts due to the United States" within the meaning of R.S. §3466.

STATEMENT.

This is a proceeding to establish a claim on behalf of the Small Business Administration against a bankrupt, and to determine the priority status, if any, of the claim.

The facts are not in dispute.

On November 19, 1956, a participation agreement was entered into between the Small Business Administration and the Brookville State Bank, Brookville, Kansas. (Exhibit A, R. 4-9). This agreement recites that S. H. Byquist, d/b/a Western Distributors, "has made application for a loan in the amount of $20,000.00" and "S.B.A. desires to purchase a participation of 75% of the loan or such part thereof as bank may disburse to borrower." (Exhibit A, R. 4)

By the participation agreement, the Small Business Administration agreed that upon written demand by the bank, it would purchase from the bank a participation of 75% of each disbursement made by the bank. (Exhibit A, ¶ 2, R. 4). It was further agreed that the bank and S.B.A. would share ratably in accordance with their respective interests in the loan any income, expenses, or losses. (Exhibit A, ¶¶ 12, 13, 14, R. 8-9).

The Brookville State Bank did lend to S. H. Byquist, d/b/a Western Distributors, $20,000.00, evidenced by a promissory note dated November 16, 1956, payable to the order of the Brookville State Bank, Brookville, Kansas. (Exhibit B, R. 9-13). The bank, pursuant to the provisions of paragraph 2 of the participation agreement, made written demand on S.B.A. for purchase of 75% of the disbursement. (Exhibit F, R. 27). Pursuant to the participation agreement and this demand, S.B.A. sent a check for $15,000.00, dated November 23, 1956, to the bank (Exhibit C, R. 15), for purchase of its participation in the loan to Byquist.

On September 5, 1957, S. H. Byquist, an individual, d/b/a Western Distributors, was adjudicated a bankrupt. (R. 32).

Subsequent to the institution of the bankruptcy proceedings and the adjudication in bankruptcy, the Brookville State Bank assigned the note to Small Business Administration. (R. 32).

On October 15, 1957, Small Business Administration duly filed a proof of claim in bankruptcy for the full unpaid balance of the note. (R. 2-3).

On November 22, 1957, after all due credits were given there remained due on said note the sum of $16,355.69, with interest paid to the date of bankruptcy. (R. 32).

The total gross estate in the hands of the trustee is approximately $19,000.00, against which claims totaling $43,682.07 have been filed. (R. 32).

The trustee duly filed objection to the allowance of the S.B.A. claim as a priority claim on the grounds that S.B.A. was created as a separate entity and was not invested with the sovereign privileges and immunities of the United States (*Sloan Shipyards Corporation* v. *United States Shipping Board*, 258 U.S. 549, 66 L. Ed. 762; *RFC* v. *J. H. Menihan Corp.*, 312 U.S. 81, 85 L. Ed. 595; *Nathanson* v. *National Labor Relations Board*, 344 U.S. 25, 97 L. Ed. 23); that the assignment of this claim occurred after the date of bankruptcy, or insolvency and no debt was due to the Small Business Administration at the date of bankruptcy (*United States* v. *Marxen*, 307 U.S. 200, 8. L. Ed. 1222); that the allowance of the priority would be inconsistent with the Small Business Act of 1953 and other statutes and acts of Congress (*United States* v. *Guaranty Trust Company*, 280 U.S. 478, 74 L. Ed. 556; *National Bank* v. *United States*, 107 U.S. 445, 27 L. Ed. 537; *Davis* v. *Pringle*, 268 U.S. 315, 69 L. Ed. 974); and, that the allowance of the priority would be inconsistent with the purpose for which the priority was granted. (*Nathanson* v. *National Labor Relations Board*, 344 U.S. 25, 97 L. Ed. 23; *United States* v. *Marxen*, 307 U.S. 200, 87 L. Ed. 1222).

The referee denied priority on the ground that the S.B.A. is a separate entity. (R. 33-36). The District Court denied priority on the ground that there was a post bankruptcy assignment. (R. 38-43). The Court of Appeals held the determining fact to be:

> "* * * that SBA has by written contract with the bank agreed to share ratably the proceeds and losses resulting from the transaction with Byquist.

"Marxen holds that absent controlling legislation, which is not present here, section 3466 grants priority only to the United States. In *Nathanson* v. *National Labor Relations Board*, 344 U.S. 25, 28, it was said that section 3466 may not be extended to create a priority for a claim which the United States is collecting for a private party. This principle would be violated if the claim of the United States were here given priority.

"The United States is bound by its written contract to the bank for the bank's 25% share of any collection made under the note. Hence, the bank would share to that extent in any proceeds resulting from the award of a priority to the United States. No such priority in a private creditor is provided by section 3466.

"The Bankruptcy Act is intended to bring about an equitable distribution of the bankrupt's estate among creditors holding just demands. The use of section 3466 to prefer the bank over other private creditors would defeat that intent.

"The United States has engaged in a commercial enterprise and made no effort to safeguard its rights under section 3466. In a contract made on its own forms it has agreed to share ratably proceeds and losses. It may not assert a priority which will produce a recovery that by contract must be divided with a private entity." (R. 49).

The Small Business Administration duly filed a petition for certiorari which was granted on April 18, 1960. (R. 51).

SUMMARY OF THE ARGUMENT.

Small Business Administration contends that it is entitled to priority by virtue of Section 64, Fifth (11 U.S.C.A. §104(5)) of the Bankruptcy Act providing a priority of the fifth class to "debts owing to any person, including the United States, who by the laws of the United States is entitled to priority, * * *", and by virtue of R.S. §3466 (31 U.S.C.A. §191) which provides, "whenever any person indebted to the United States is insolvent, * * * the debt due to the United States shall be first satisfied; * * *".

It has often been stated the purpose of R.S. §3466 is to secure adequate public revenues to sustain the public burden and discharge the public debt. It is also well established that the statute is to be liberally construed to effectuate that purpose. See *e. g., United States* v. *Emory*, 314 U.S. 423, 86 L. Ed. 315; *Nathanson* v. *National Labor Relations Board*, 344 U.S. 25, 97 L. Ed. 23.

"But the rule of liberal construction has its limitations beyond which a Court cannot go" (*U. S. v. Johnson*, (C.A. 10) 87 F.2d 155, 161), and "this Court has in the past recognized that certain exceptions could be read into this statute." (*United States* v. *Waddill, Holland & Flynn*, 323 U.S. 353, 354, 89 L. Ed. 294, 299).

It has thus been held that the priority does not arise in the following situations:

1. When the allowance of the priority would be inconsistent with the purpose for which the priority was granted. *Nathanson* v. *National Labor Relations Board*, 344 U.S. 25, 97 L. Ed. 23; *United States* v. *Marxen*, 307 U.S. 200, 84 L. Ed. 1222.

2. When the allowance of the priority would be inconsistent with other statutes and acts of Congress. *United*

States v. *Guaranty Trust Company*, 280 U.S. 478, 74 L. Ed. 556; *National Bank* v. *United States*, 107 U.S. 445, 27 L. Ed. 537; *United States* v. *Sampsell*, (C.A. 9) 153 F.2d 731; *Davis* v. *Pringle*, 268 U.S. 315, 69 L. Ed. 974.

3. To general claims in bankruptcy transferred to the United States, or to which it has become subrogated on payment, after the filing of the petition in bankruptcy. *United States* v. *Marxen*, 307 U.S. 200, 83 L. Ed. 1222.

4. When the debt is not due to the United States as such. It is not one owing to the United States merely because it is owed to an agency of the United States. It depends in each case upon the nature of the agency and the nature of the debt. *Sloan Corporation* v. *United States Shipping Board*, 258 U.S. 549, 66 L. Ed. 726; *Nathanson* v. *National Labor Relations Board*, 344 U.S. 25, 97 L. Ed. 23.

I.

Respondent submits that the allowance of a priority in this case would be inconsistent with the purpose of R.S. §3466; inconsistent with the purpose of the Bankruptcy Act; and, inconsistent with the purpose of the Small Business Act itself. Points 1 and 2 above will be argued together in this brief.

It is conceded that the S.B.A. will be required to share with the Brookville State Bank any recovery it obtains in excess of the dividend to ordinary creditors. To the extent that it is required to share this recovery, the proceeds will not be available "to sustain the public burden and discharge the public debt", but rather will redound to the benefit of a private entity, thus thwarting the purpose of R.S. §3466.

The purpose of the Bankruptcy Act is to bring about an equitable distribution of the bankrupt's estate among

creditors holding just demands. By virtue of receiving a share of proceeds of the bankrupt's estate distributed to S.B.A., the Brookville State Bank, a common creditor with no superior equities, would be preferred over the other common creditors, and the purpose of the Bankruptcy Act would be thwarted.

The declared purpose of the Small Business Act is to aid and foster small business by extension of credit with the intention of encouraging and developing the actual and potential capacity of small business, and to allow for their expansion and growth, thus maintaining and strengthening the overall economy of the nation. If suppliers of goods and services knew that in the event of insolvency their claims would be subordinated to those of the United States, they would refuse to extend credit to those concerns, whose very credit S.B.A. is attempting to foster and promote, and thus the purpose of the Small Business Act would be thwarted. Additionally, the Small Business Act unmistakably evidences a purpose to rely on other means than the priority provided for by R.S. §3466 to obtain repayment of advances.

II.

There was no debt due to S.B.A., or the United States at the date of bankruptcy.

The claim of S.B.A. is based on a note executed by the bankrupt and payable to the Brookville State Bank. On the date of bankruptcy the Bank was the holder and sole payee on the note. Subsequent to the adjudication in bankruptcy the note was assigned to S.B.A. S.B.A. then filed its claim on the note against the bankrupt. Prior to the assignment of the note, S.B.A. had no enforceable claim of any kind against Byquist. Under such a state of facts this Court has held that the United States as assignee

has no greater rights than the assignor possessed prior to the assignment.

While S.B.A. had entered into an agreement with the Bank in connection with this loan, there was no privity between S.B.A. and Byquist. S.B.A. was not a party-lender, nor did its purchase of a participation from the bank purport to constitute an assignment of the note or any part of it to S.B.A. S.B.A. obtained the right to participate with the bank in the proceeds of the loan and the right to a future assignment of the note from the bank on demand. Under its agreement, S.B.A.'s rights were against the bank and not against Byquist. Until the assignment of the note occurred there was no debt due from Byquist to the S.B.A.

III.

A debt due the S.B.A. is not a debt due to the United States within the meaning of R.S. §3466.

The immunities and priorities of the United States do not extend to separate entities through which it may choose to transact its business. The Small Business Act creates an agency under the name, "Small Business Administration" which is under the general direction and supervision of the President and is not affiliated with or within any other agency or department of the federal government. The management of the Administration is vested in an administrator appointed by the President. It is authorized to obtain money from a revolving fund in the Treasury of the United States for use in the performance of the powers and duties granted to or imposed upon it by law. It must pay interest on the net amount drawn at the end of each fiscal year. It may enter into contracts, including the power "to enter into contracts with the United States Government and any department, agency or officers

thereof", buy and sell property, and sue and be sued in any court of record of a state having general jurisdiction or in any United States District Court. The various powers granted to the Small Business Administration constitute it a separate legal entity. No priority is specifically granted to it, and it is not entitled to claim the priority granted to the United States. No debt is here owed to the United States. Upon its acquisition of the note, a debt became due to the Small Business Administration. The administration is obligated to pay "at the close of each fiscal year, interest on the net amount of cash disbursements from advances" made to it. It is not required to account for specific loans to the United States. Any recovery here will go to the revolving fund of the S.B.A., which, although maintained in the Treasury of the United States, is not a payment to the United States. Assuming the Administration has followed the Congressional mandate, and that the totality of loans made have been of "such sound value or so secured as reasonably to assure repayment", it is difficult to see where the United States as such, would stand to gain or lose, as a result of any claim made by the Small Business Administration.

ARGUMENT.

I.

Allowance of the Priority Would Be Inconsistent with Other Statutes and Acts of Congress.

A. R.S. 3466 and the Bankruptcy Act

On October 15, 1957, the S.B.A. filed its proof of claim in bankruptcy in this matter. The claim is for $16,788.42 (it was subsequently stipulated the correct figure, after all credits were given, is $16,355.69 (R. 32)) and alleges "said

sum represents the total indebtedness due and payable by bankruptcy by virtue of the failure to repay to Small Business Administration the indebtedness arising from the loan made by the Brookville State Bank, Brookville, Kansas, to said Bankrupt; * * *" (R. 2-3). The claim further alleges:

> "4. That the consideration of said indebtedness is as follows:
>
> (a) A Note in the principal amount of $20,000.00, duly executed and delivered to the said bank and thereafter assigned to the Small Business Administration pursuant to the Participation Agreement, attached as 'Exhibit A'. Attached hereto and made a part hereof and marked 'Exhibit B' is a photostatic copy of the above-mentioned Note." (R. 3).

The participation agreement attached to the proof of claim as Exhibit "A" is an agreement between the Brookville State Bank and the Small Business Administration. It recites that S. H. Byquist, d/b/a Western Distributors, has made application for a loan in the amount of $20,000.00 and S.B.A. desires to purchase a participation of 75% of the loan. The agreement provides:

> "2. Purchase of Participation.—SBA, upon written demand by Bank, will purchase from Bank a participation of 75 per cent of each disbursement made by Bank to Borrower on account of the Loan, immediately after such disbursement, for an amount of money equal to the amount of said participation. Immediately upon each such purchase, Bank will execute and deliver to SBA a Participation Certificate on SBA Form 152* evidencing the interest in the Loan so purchased. (Exhibit A; ¶ 2, R. 4).
>
> * * *

"10. Advice to SBA.—Immediately upon making each disbursement to Borrower on account of the Loan, Bank will advise SBA in writing of the date and amount of such disbursement. Immediately upon receipt by Bank of any payment by Borrower of principal of or interest on the Loan, Bank will advise SBA in writing of the date and amount of each such payment. Upon the happening of any default by Borrower under the provisions of the Note or any other agreement in connection with the Loan, coming to the knowledge of Bank, Bank will within ten days thereafter forward appropriate notice thereof to SBA. Bank will at any time and from time to time, forward to SBA such other information and advice in connection with the Loan as SBA may request. If and when requested by SBA, Bank will furnish SBA with a conformed copy of the Note, instruments of hypothecation and all other agreements and documents obtained by Bank in connection with the Loan. (Exhibit A, ¶ 10, R. 7).

* * *

"11. Possession of Note and Collateral.—Bank shall, * * * hold the Note, all the collateral therefor and all instruments delivered in connection therewith; Provided, however, That subsequent to the purchase by SBA of a participation in the Loan and upon written demand Bank shall five days after receipt of said demand transfer to SBA, without recourse, the Note, collateral, and instruments, all of which shall thereafter be held by SBA, and simultaneously therewith SBA shall issue to Bank a Certificate of Interest (on SBA Form 156*) evidencing the interest retained by Bank in the Loan. (Exhibit A, ¶ 11, R. 8).

"12. Administration of Loan.—The holder of the Note shall receive all payments on account of principal of, or interest on, the Loan and promptly remit to the other party its pro rata share thereof determined according to their respective interests in the Loan, * * *. (Exhibit A, ¶ 12, R. 8).

* * *

expect to receive would be approximately 2% if, in fact, they received any dividend at all. If the priority should be allowed as to $12,266.77, of this $16,355.69 claim and the balance be allowed as a common claim, there would be a total recovery on the claim of $12,348.53, assuming a 2% dividend on the balance. Under the participation agreement on which S.B.A. bases its claim, $3,087.13 of this amount would be payable to the Brookville State Bank.

The Brookville State Bank would therefore receive from the assets of the bankrupt approximately 75% of its claim, while the other common creditors receive only 2%.

> "The broad purpose of the Bankruptcy Act is to bring about an equitable distribution of the bankrupt's estate among creditors holding just demands * * *." (*Kothe* v. *R. C. Taylor Trust*, 280 U.S. 224, 227, 74 L. Ed. 382).
>
> "The theme of the Bankruptcy Act is 'equality of distribution' (*Sampsell* v. *Imperial Paper & Color Corp.*, 313 U.S. 215, 219, 85 L. Ed. 1293, 1298, 61 S. Ct. 904); and if one claimant is to be preferred over others, the purpose should be clear from the statute." (*Nathanson* v. *National Labor Relations Board*, 344 U.S. 25, 29, 97 L. Ed. 23, 29).

Here, the bank as a common creditor with no superior equities, would be preferred over other common creditors contrary to the purpose of the Bankruptcy Act to bring about an equitable distribution of the bankrupt's estate among creditors holding just demands. The S.B.A., on the other hand, would not enjoy the fruits of the priority since under the participation agreement it would not retain the amount for which the priority was allowed.

In *United States* v. *Marxen*, 307 U.S. 200, 83 L. Ed. 1222, this Court, after announcing the principle that R.S. §3466 is

"14. Liability and Representations.—Neither party hereto makes any express or implied warranty of any kind with respect to the Loan and neither party shall be liable to the other for any loss, not due to its own gross negligence, but such loss shall be borne ratably by SBA and Bank in accordance with their respective interests in the Loan." (Exhibit A, ¶ 14, R. 9).

The claim of the S.B.A. filed herein is for the full unpaid balance of the note. It is prosecuting this claim for itself and for the Brookville State Bank as their interests may appear. By the terms of the participation agreement, the S.B.A., as holder of the note, must remit promptly to the bank its pro rata share of any recovery obtained. The participation agreement also provides "any loss * * * shall be borne ratably by SBA and Bank in accordance with their respective interests in the Loan."

If this claim is allowed in full and an ordinary dividend paid upon it, and if the S.B.A. remits to the bank its pro rata share of that dividend, all of the requirements of the participation agreement will have been fulfilled. S.B.A. and the bank will have shared ratably the proceeds of the note, and the loss will have been borne ratably by S.B.A. and the bank in accordance with their respective interests in the loan.

S.B.A. from the outset has recognized that a part of the amount which it seeks to collect it is collecting for and on behalf of the bank. In asserting its priority, in a partial recognition of the participation agreement, it has claimed priority for only 75% of the total claim, or $12,266.77.

Let us examine the practical result of the allowance of a priority in that amount in this case. If no priorities are allowed, all of the creditors will receive a dividend of approximately 30%. If the priority claimed by S.B.A. were allowed, the greatest dividend the common creditors could

to be construed liberally to effectuate its purpose to protect the public revenues said:

> "But this principle of construction is subject to the limitation that the generality of the language of the section is restricted by the purpose to grant priority to the United States, only, and by legislative intention, as shown by other statutes." (206).

In *Nathanson* v. *National Labor Relations Board*, 344 U.S. 25, 97 L. Ed. 23, it was said that R.S. §3466 may not be extended to create a priority for a claim which the United States is collecting for the benefit of a private party.

S.B.A. acknowledges that a part of its total claim of $16,355.69 is being collected on behalf of the Brookville State Bank. By the same reasoning by which S.B.A. initially claimed priority to only $12,266.77, it might claim priority to only $9,261.40, the amount it would be entitled to retain under the distribution set out above. Here, again, however, while the dividend to the common creditors would be somewhat increased, the recovery by S.B.A. by virtue of its priority would have to be shared with the bank under the participation agreement. This again would result in an inequitable preference of the bank, and S.B.A. would not retain the amount recovered by virtue of the priority.

The only point at which a dividend can be allowed on this claim without resulting in a sharing by S.B.A. and a preference to the bank, thus satisfying and enforcing the provisions of both the participation agreement and the Bankruptcy Act, is by allowance of the claim as a common claim without priority. At that point, and at that point only, the bank and S.B.A. will share ratably, according to their respective interests in the loan, the proceeds of the loan and the loss sustained on the loan, so that no amount

will be due by either to the other, and no inequitable preference will result to the bank.

Insofar as any amount is recovered by the Small Business Administration in excess of an ordinary dividend, a part of that excess must be divided with the bank. So much of the recovery as must, under the participation agreement, go to the bank, is not satisfying a debt due to the United States. The collection of that amount by Small Business Administration is for the benefit of a private party.

Petitioner, in its brief, distinguishes the *Nathanson* case on the ground that whereas, in *Nathanson* the United States was not the beneficial owner of any part of the debt, in this case it is.

It is true that in *Nathanson* the Board had no beneficial interest in the claim. It is true, also, that in this case S.B.A. had paid out of its revolving fund, $15,000.00 to the Bank for the purchase of an interest in a loan which the bank had theretofore made by Byquist. And, it is true that this had turned out to be a poor investment and only some $3,750.00 of its principal had been recovered at the time of bankruptcy. But, at the time the agreement with the bank was entered into, the parties recognized the risks attendant upon the lending of money, and so they inserted a clause in their contract with respect to losses. They provided that neither party should be liable to the other for any loss, not occasioned by its own gross negligence, and that "such loss, shall be borne ratably by S.B.A. and Bank in accordance with their respective interests in the Loan."

We submit that the "beneficial interest" of S.B.A. must be determined by the entire contract with the bank. Its "beneficial interest" certainly must be limited to the amount by which it will benefit. May the S.B.A. assert

a priority for $12,000.00 of which it may retain only $9,000.00, and contend it is "beneficially interested" in the entire $12,000.00? Would not the $3,000.00, it thereby recovered, be recovered for the benefit of a private party? It has a beneficial interest in a priority on $12,000.00 only because a priority in that amount would reduce the loss sustained by both the bank and S.B.A., and it could retain more of the amount recovered. Can it then be said that S.B.A. has a beneficial interest in $9,000.00, and the priority should be allowed in that amount? We submit it cannot. In that event S.B.A. would still be required to share the amount recovered with the bank, and as petitioner says in its brief "and so on, *ad infinitum*".

Petitioner, in its brief, suggests two solutions to this problem. First, that the priority be allowed for the full amount of the note, to assure that the lesser amount claimed by S.B.A. will be paid in full; and, second, that the Court simply allow the S.B.A. to breach its contract, and deny the bank any participation.

While it is true that by allowing a priority for the full $16,000.00, the S.B.A., in this case, would recover substantially all of its money; that would do violence to the priority statute, as well as be directly contrary to the decision of this Court in the *Nathanson* and *Marxen* cases. It does, however, serve to point up the argument we have made above.

S.B.A. has never contended that either Byquist or the bank was ever indebted to it or the United States in any such sum. It is only by allowing some other private entity to also have a priority that the debt due to S.B.A. could be satisfied. The result would not be that the debt due the United States was first satisfied, but that the debt due the United States and some other person or entity were satisfied.

Marxen says that R.S. §3466 grants priority to the United States only. *Nathanson* says R.S. §3466 may not be extended to create a priority for a claim which the United States is collecting for a private party.

As to the suggestion that a proper solution would be to simply disregard the obligations of the contract, and allow the bank to participate in any recovery by S.B.A., on the ground that it is against public policy, suffice it to say that Congress specifically authorized just such a contract as was here made.

The Small Business Act provides:

> "(a) The Administration is empowered to make loans * * * and such loans may be made or effected either directly or in cooperation with banks or other lending institutions through agreements to participate on an immediate or deferred basis." (15 U.S.C. §636 (a)).

By its participation with ordinary commercial banks or other lending institutions, in ordinary commercial loans, the claims made by Small Business Administration are so affected by a private non-governmental interest that the allowance of any priority would be inequitable and inconsistent with the purposes of the Bankruptcy Act, and with R.S. §3466 itself.

As early as 1824, in *Bank of the United States* v. *Planters Bank*, 9 Wheat. 904, 6 L. Ed. 244, this Court said:

> "It is, we think, a sound principle, that when a Government becomes a partner in any trading company, it divests itself, so far as concerns the transactions of that company, of its sovereign character, and takes that of a private citizen. Instead of communicating to the company its privileges and its prerogatives, it descends to a level with those with whom it associates itself, and takes the character which belongs to

its associates, and to the business which is to be transacted. * * *"

In *Mellon* v. *Michigan Trust Co.*, 271 U.S. 236, 70 L. Ed. 924, the Court said:

> "As said in *Davis* v. *Pullen*, (C.C.A. 1st) 277 Fed. 650, 655, 'there is a certain obvious injustice in giving the United States when engaged in an industrial and commercial venture, even although under war powers, superior rights over other creditors bearing like relations to insolvents.'"

And the Court found it unnecessary to cause such injustice and held:

> "To permit the claim preference, we think, would conflict with the spirit and broad purpose of the statute. These become plain enough upon consideration of the just ends which Congress had in view together with the recent policy, revealed by the Bankruptcy Act, in respect to priorities."

B. The Small Business Act.

We believe the allowance of the claimed priority would be plainly inconsistent with the declared and apparent purposes of the Small Business Act, and on the authority of *United States* v. *Guaranty Trust Co.*, 280 U.S. 478, 74 L. Ed. 556, the claimed priority should be denied.

While it has been held that only the plainest inconsistency between R.S. §3466 and subsequent Congressional legislation warrants the finding of an implied exception to the statute, it has been clearly recognized that where such inconsistency exists R.S. §3466 is inapplicable. *United States* v. *Guaranty Trust Co.*, 280 U.S. 478, 74 L. Ed. 556; *United States* v. *Emory*, 314 U.S. 423, 86 L. Ed. 315; *National Bank* v. *The United States*, 107 U.S. 445, 27 L. Ed. 537; *United States* v. *Remund*, 330 U.S. 539, 91 L. Ed. 1082; *Massachusetts* v. *United States*, 333 U.S. 611, 92 L. Ed. 968.

In *United States* v. *Guaranty Trust Co.*, 280 U. S. 478, 74 L. Ed. 556, the claims arose out of Title II of the Transportation Act of 1920. That act provided for the funding of debts which the railroads had contracted during the period of war time control, and also provided for new loans to the railroads. The Court held R.S. §3466 inapplicable to the collection of these loans. The Court found that at the time of the passage of the act most of the railroads of the United States "lacked funds for necessary improvements, equipment, and expansion of facilities." (p. 484). Some of the carriers needed funds to meet maturing obligations. The credit of many carriers was seriously impaired. There was a reluctance among investors to purchase new railroad securities. "Congress deemed it important to preserve for the nation substantially the whole existing transportation system." (p. 484). In order to accomplish this, it was thought necessary that the United States should finance the carriers until it would become possible to restore their credit. The provisions of Title II of the Transportation Act were framed to that end. The Court held, "to have given priority to debts due the United States pursuant to Title II would have defeated the purpose of Congress." (p. 485). The Court said that the allowance of the priority not only would have prevented the re-establishment of railroad credit, but would even have seriously impaired the market value of outstanding railroad securities. "It would have deprived the carriers of the credit commonly enjoyed from supply men and others; would have seriously embarrassed the carriers in their daily operations, and would have made necessary a great enlargement of their working capital." (p. 485). The Court concluded, "the entire spirit of the act makes clear the purpose that the rule leading to such consequences should not be applied." (p. 485).

The Court also found in that case that Congress evidenced unmistakably its purpose to rely, for obtaining payment of the Government advances, upon other means than the priority provided for by R.S. §3466. The evidence found by the Court was that "under all of the sections, the giving of adequate security was either required or left to the discretion of the President"; that "no advance could be made, unless the Interstate Commerce Commission was satisfied that the earning power of the carrier and the security given furnished reasonable assurance that the loan would be repaid and all obligations in connection therewith would be performed." (p. 485). The Court then concluded, "thus, both the general purposes of Title II and its specific provisions make it clear that Congress intended to exclude the indebtedness so arising from the scope of §3466 of the Revised Statutes, * * *." (p. 486).

The general purposes of the Small Business Act and its specific provisions make it equally clear that Congress intended to exclude indebtedness arising under that Act from the scope of R.S. §3466; and, in the Small Business Act, as in the Transportation Act, Congress evidenced unmistakably its purpose to rely, for obtaining payment of the Government's advances, upon other means than the priority provided for by R.S. §3466.

The purpose of the Small Business Act is set forth in its first section (15 U.S.C. §631), which states:

> "(a) The essence of the American economic system of private enterprise is free competition. Only through full and free competition can free markets, free entry into business, and opportunities for the expression and growth of personal initiative and individual judgment be assured. The preservation and expansion of such competition is basic not only to the economic well-being but to the security of this nation.

Such security and well-being cannot be realized unless the actual and potential capacity of small business is encouraged and developed. It is the declared policy of the Congress that the Government should aid, counsel, assist, and protect, insofar as is possible, the interests of small business concerns in order to preserve free competitive enterprise, to insure that a fair proportion of the total purchases and contracts for property and services for the Government (including but not limited to contracts for maintenance, repair, and construction) be placed with small business enterprises, to insure that a fair proportion of the total sales of Government property be made to such enterprises, and to maintain and strengthen the overall economy of the nation."

To carry out this policy:

"(a) The administration is empowered to make loans to enable small business concerns to finance plant construction, conversion, or expansion, including the acquisition of land; or to finance the acquisition of equipment, facilities, machinery, supplies, or materials; or to supply such concerns with working capital to be used in the manufacture of articles, equipment, supplies, or materials for war, defense, or civilian production or as may be necessary to insure a well balanced national economy; * * *" (15 U.S.C. §636(a)).

This language is substantially identical with the language of the Court in the *Guaranty Trust Company* case where it said:

"These appropriations were made in order to meet a pressing need. At the time of the passage of the Transportation Act 1920, most of the railroads of the United States lacked funds for necessary improvements, equipment, and expansion of facilities." (p. 484).

Sound business requires a good credit standing and a substantial line of open account credit with suppliers of

goods and services. It is particularly essential to small business. Without such credit the working capital requirements of such a business would be overwhelming.

The declared policy of the Congress is to "aid, counsel, assist, and protect" the interests of small business concerns in order to preserve free competitive enterprise. "Only through full and free competition can free markets, free entry into business and opportunities for the expression and growth of personal initiative and individual judgment be assured."

To give priority to debts due the S.B.A. would defeat the purpose of Congress. We submit that if suppliers of goods and services knew that in the event of insolvency their claims would be subordinated to those of the S.B.A., they would refuse to extend credit to these concerns whose very credit the S.B.A. is attempting to foster and promote. In that event the obtaining of an S.B.A. loan would certainly be a prelude to bankruptcy.

Petitioner, at page 38 of its Brief, points out that "an identical argument was made to this Court in *United States* v. *Emory*, 314 U.S. 423, 86 L. Ed 315, as a reason for not granting priority to a loan made pursuant to the National Housing Act", and that the Court rejected the argument in that case.

In the *Emory* case the Court held that the purpose of the National Housing Act "was not the strengthening of the general credit of the property owners [the borrowers], but the stimulation of the building trades by affording assurances to lending institutions in order to induce them to make loans for property improvements. No security was required of the borrowers, and the interest charge was low." (p. 433).

No embarrassment would be caused to the building trades, the trade intended to be benefited under the National Housing Act, by enforcement of the priority against the borrower, the property owner, in case of default.

That is not the case here. Under the Small Business Act, the purpose, as stated in the act itself is to benefit the borrowers, the small business organizations, and they would be embarrassed by the enforcement of the priority, and the purpose of Congress to benefit them would be defeated.

Petitioner also points out that the argument was again rejected in *United States* v. *Remund*, 330 U.S. 539, 91 L. Ed. 1082. That case involved emergency feed and crop loans made by the Farm Credit Administration. As to the purpose for which those loans were made, this Court said:

> "But it is manifest that the purpose of the acts of February 23, 1934, and June 19, 1934, was to give emergency relief to distressed farmers rather than to restore their credit status. These were but two of a series of emergency seed and crop loan statutes enacted at the various times from 1921 to 1938, a period when farmers were the victims of repeated crop failures and adverse economic conditions. Their credit was often impaired, but their most urgent need was for money to purchase feed and to plant crops; without such money, distress and unemployment might have been their lot. It was to meet that urgent need that Congress passed these statutes." (pp. 543-544).

The Court concluded:

> "We conclude that there is no irreconcilable conflict between giving emergency loans to distressed farmers and giving priority to the collection of these loans pursuant to section 3466. Such priority could in no way impair the aid which the farmers sought through these loans; nor could it embarrass the farmers

in their daily operations. Moreover, these loans called for a first lien on crops growing or to be grown, or on livestock. The conditions prevailing in 1934, made this type of security uncertain and there is no indication that Congress meant such a lien to be the sole security to which the Government could look for repayment." (p. 544).

The situation here is wholly unlike that considered in the *Emory* case, where a trade with whom the borrower would do business was intended to be benefited rather than the borrower himself, or the *Remund* case where the purpose was to give emergency loans to distressed farmers. Under the Small Business Act "the actual and potential capacity of small business is [to be] encouraged and developed." This capacity certainly will not be encouraged and developed by a course of action tending to curtail or restrict open lines of credit.

The purpose to rely upon other means than the priority provided for by R.S. §3466 is clearly evidenced in the Small Business Act and the regulations promulgated pursuant thereto.

The act provides:

"(7) All loans made under this sub-section shall be of such sound value or so secured as reasonably to assure repayment." (15 U.S.C. §636(a)(7)).

The loan policy statement in regard to business loans contained in the regulations promulgated under the Small Business Act provide:

"(c) No loan shall be made unless there exists reasonable assurance that it can and will be repaid pursuant to its terms. Reasonable assurance of repayment will exist only where the loan is of sound value, or is adequately secured in the judgment of SBA. It will be deemed not to exist when the proposed loan is

to accomplish an expansion which is unwarranted in the light of the applicant's past experience and management ability, or when the effect of making the loan is to subsidize inferior management." (13 CFR §120.4-2 (c)).

And in the regulations relating to limited loan participation, it is provided:

"(c) Emphasis shall be on the repayment ability of the borrower as determined from the record of past earnings.

"(d) All such loans shall be secured; however, the participating bank shall be responsible for obtaining the pledge of collateral as well as determining the adequacy thereof. Security may include, but shall not be limited to, mortgage on real or personal property, assignment of accounts receivable or moneys due on contracts, pledge of warehouse receipts and guarantees." (13 CFR §120.4-4(c)(d)).

The declared purpose of the Small Business Act for the well-being of the nation is to encourage and develop the potential capacity of small business by making money and credit available to such businesses and to aid, counsel, assist and protect insofar as possible the interests of small business concerns. Both the general purposes of the Small Business Act and its specific provisions make it clear that Congress intended to exclude the indebtedness so arising from the scope of R.S. §3466.

II.

No Debt Was Due to SBA or the United States at the Date of Bankruptcy.

It is now settled that the status of a claim against a bankrupt is fixed at the date the petition is filed. Where a claim is thereafter transferred or assigned to the United

States, the United States as assignee is entitled to no greater rights than its assignor, and priority under R.S. § 3466 will be denied. *United States* v. *Marxen*, 307 U.S. 200, 83 L. Ed. 1222; *Sexton* v. *Dreyfus*, 219 U.S. 339, 55 L. Ed. 244; *Groggin* v. *Labor Division*, 336 U.S. 118, 93 L. Ed. 543; *In Re Hansen Bakers*, 103 F.2d 665; *In Re Miller*, 105 F.2d 926; *Corman* v. *Federal Housing Admr.*, 113 F.2d 743.

This claim is based upon a note executed by S. H. Byquist to the Brookville State Bank. The proof of claim filed by the S.B.A. herein states the consideration of said indebtedness is "a Note in the principal amount of $20,000.00, duly executed and delivered to said Bank and thereafter assigned to the Small Business Administration * * *". (R. 3). It has been stipulated that the note was assigned to Small Business Administration following the adjudication of S. H. Byquist a bankrupt. (R. 32).

On the date of bankruptcy, the Brookville State Bank was the holder and sole payee of the note. Prior to the assignment of the note to it, S.B.A. had no enforceable claim of any kind against Byquist. There was no privity between S. H. Byquist and the Small Business Administration.

At the date of bankruptcy the only contract in which Small Business Administration was interested was a contract with the Brookville State Bank. By that contract Small Business Administration agreed to purchase a part of a loan proposed to be made by the Brookville State Bank. S.B.A. was not a party lender. The Brookville State Bank was to continue as the holder and owner of the note. It was obligated to account to Small Business Administration for its pro rata share of each payment made by the borrower, and to use due diligence to recover all payments from the borrower. S.B.A. obtained the right to participate with the bank in the proceeds of the loan, and the right to demand an assignment of the note and col-

lateral. The bank was obligated to make such assignment within five (5) days after receipt of a written demand for such transfer. Until such assignment was made, S.B.A.'s only recourse was against the bank. At the time the bankruptcy proceedings were instituted, the Small Business Administration had no enforceable claim against the bankrupt.

All of the evidence in this case shows that no present assignment of all or any part of the note was intended by either the bank or S.B.A. by the purchase of a participation therein by S.B.A.

The participation agreement between S.B.A. and the bank, in paragraph 11, provides:

> "* * * That subsequent to the purchase by SBA of a participation in the Loan and upon written demand Bank shall five days after receipt of said demand transfer to SBA, without recourse, the note, collateral, and instruments, all of which shall thereafter be held by SBA, * * *" (Exhibit A, ¶ 11, R. 8).

This gives the S.B.A. a right to demand an assignment in the future, a right against the bank; it negatives any idea that a present assignment of the note was intended.

An agreement to assign or an unexecuted intent to assign at some time in the future is not an assignment.

Southern Lumber Company v. *Pearce*, 59 F.2d 50 (C.A. 5);

Turner v. *Williams*, 114 Kan. 769, 773-774, 221 Pac. 267, 269.

Since no present assignment of the debt was intended by either of the parties, S.B.A. could not even have contended that there was an equitable assignment enforceable by it against the bankrupt. If an assignment was to be made, it would be made at a future time. Until such an

assignment was made, the debt was owed to the bank alone as payee in the note. Until an assignment was made, S.B.A. could not have instituted any action against S. H. Byquist. What S.B.A. had by virtue of its contract with the bank, and by purchase of a participation in the loan, was a right to participate in the proceeds of the loan as they were paid; and, the right to demand an assignment of the loan.

Recognizing that it had no enforceable claim against the bankrupt until the assignment of the note was made, and subsequent to the institution of the bankruptcy proceedings, S.B.A. demanded and obtained an assignment of the note, and filed its claim for the full unpaid principal balance of the note. This was properly done. Its claim, however, is an assigned claim in which the assignment occurred after the date of bankruptcy and it is not entitled to priority.

The S.B.A., in its brief filed herein, takes the position that from the time S.B.A. bought its participation in the loan, it was necessarily a creditor of the bankrupt. In support of its position petitioner cites *In re Westover, Inc.*, 82 F.2d 177 (C.A. 2); *In re Prudence Bonds Corp.*, 79 F.2d 212 (C.A. 2); *Delatour* v. *Prudence Realization Corp.*, 167 F.2d 621 (C.A. 2); *In re Prudence Co.*, 89 F.2d 689 (C.A. 2), holding that the holders of participation certificates issued by a mortgagee evidencing participating interest in the mortgage and bond are creditors of the mortgagor, not of the mortgagee. It also cites *In re Hawley Down-Draft Furnace Co.*, 238 Fed. 122 (C.A. 3); *Cogan* v. *Conover Mfg. Co.*, 69 N.J. Eq. 809, 64 Atl. 973, on the proposition that ownership rights of an assignee are unaffected by his designation of the assignor as collecting agent.

These cases are all clearly distinguishable from the case at bar, and are not in point here.

The *Westover* and *Prudence* cases are all substantially companion cases. Each involved "participation certificates" issued by the Prudence Company. In each case the Court is careful to point out that the participation certificates were intended to and did constitute a present assignment of an undivided share of the mortgage.

Hawley Down-Draft Furnace Co. and the *Cogan* case each involved an assignment of accounts receivable without notice to the debtors. In each case there was, however, a present written assignment of the account as between the assignor and assignee.

In the case at bar neither the participation agreement nor the participation certificate issued in pursuance thereof is intended to constitute a present assignment of any part of this note. On the contrary, they show only a right to an assignment in the future. We are not here saying that the parties could not have made a present partial assignment of a part of the note,[1] but rather that they did not do so, nor attempt to do so.

The "participation certificate" executed and delivered by the bank to S.B.A. in the present case, is simply an acknowledgement by the bank of the purchase from it by S.B.A. of a participation in the loan with a right to an assignment at a subsequent time on demand by S.B.A. It does not constitute or purport to constitute an assignment of any part of the loan to S.B.A. It does not operate

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1. But see, Uniform Negotiable Instruments Law §32, which provides:

> "The Indorsement must be an indorsement of the entire instrument. An indorsement, which purports to transfer to the indorsee a part only of the amount payable, or which purports to transfer the instrument to two or more payees severally, does not operate as a negotiation of the instrument. But where the instrument has been paid in part, it may be indorsed as to the residue."

to make S.B.A. a creditor of the bankrupt. S.B.A. did not become a creditor of the bankrupt until the assignment of the note to it after bankruptcy.

III.

Debts Due to SBA Are Not Debts Due to the United States.

The United States doing business through a separate entity does not extend its sovereign immunities or its priorities to such entity unless specifically granted.

Sloan Shipyard Corp. v. *United States Shipping Board*, 258 U.S. 549, 66 L. Ed. 762;

RFC v. *J. H. Menihan Corp.*, 312 U.S. 81, 85 L. Ed. 595;

Nathanson v. *NLRB*, 344 U.S. 25, 97 L. Ed. 23;

United States v. *Edgerton & Sons*, 178 F.2d 763 (C.A. 2).

We submit that the act creating the Small Business Administration created an independent entity not invested with the sovereign privileges, immunities and priorities of the United States.

The Small Business Act (15 U.S.C. §§631-651) created an agency under the name "Small Business Administration". It is under the general direction and supervision of the President "and shall not be affiliated with or be within any other agency or department of the federal government." (§633(a)). The management of the administration is vested in an administrator appointed by the President. (§633(b)).

The administration is authorized to obtain money from the Treasury of the United States for use in the performance of the powers and duties granted to or imposed upon it by law. For that purpose an appropriation is made to

a revolving fund in the Treasury. "The administration shall pay into miscellaneous receipts of the Treasury, at the close of each fiscal year, interest on the net amount of cash disbursement from such advances at a rate determined by the Secretary of the Treasury, * * *". (§633(c)).

The administration is given the power to adopt, alter and use a seal which shall be judicially noticed. (§634(a)). It may sue and be sued in any court of record of a state having general jurisdiction, or in any United States District Court. (§634(b)(1)).

It may enter into contracts, including contracts with the United States Government and any department, agency or officer thereof. (§637(a)(1)); acquire in any lawful manner, any property, real, personal or mixed, tangible and intangible (§634(b)(5)); may assign or sell at public or private sale, or dispose of for cash or credit, upon such terms and conditions and for such consideration as the administrator shall determine to be reasonable, any evidence of debt, contract, claim, personal property or security assigned to or held by it, and may collect or compromise all obligations assigned to or held by it (§634(b)(2)(4)); and, it may deal with, complete, renovate, improve, modernize, insure, or rent or sell for cash or credit upon such terms and conditions, and for such consideration as the administrator shall determine to be reasonable any real property conveyed to or otherwise acquired in connection with the payment of loans (§634(b)(3)).

It is empowered to make loans to enable small business concerns to finance plant construction, conversion, or expansion, including the acquisition of land; to finance the acquisition of equipment, facilities, machinery, supplies, or materials; to supply such concerns with working capital to be used in the manufacture of articles, equip-

ment, supplies, or materials for war, defense, or civilian production, or as may be necessary to insure a well-balanced national economy. It may make such loans either directly or it may join with and cooperate with ordinary commercial banks or other lending institutions through agreements to participate on an immediate or deferred basis: (§636(a)).

While it is not organized as a federal corporation, the Small Business Administration has all of the powers ordinarily to be found in a corporate charter and the powers granted to it clearly constitute it a separate entity.

In its brief in this case petitioner, at page 35, states:

> "It is now firmly established that a non-incorporated agency of the United States must be regarded as the United States for the purposes of R.S. §3466."

In support of this statement it cites *United States* v. *Remund*, 330 U.S. 539, 91 L. Ed. 1082; *United States* v. *Emory*, 314 U.S. 423, 86 L. Ed. 315; and *Korman* v. *Federal Housing Administrator*, 113 F.2d 743 (C.A.D.C.). An examination of those cases will indicate that petitioner's statement is too broad.

In the *Remund* case the Court found that the Farm Credit Administration "bears none of the features of a Government corporation with a legal entity separate from the United States" and "hence any debt owed the Farm Credit Administration is a debt owed the United States within the meaning of §3466."

We submit that that case is not controlling here. Whether or not the agency is or is not a separate entity depends in each case upon the act creating the agency. Throughout its history the Farm Credit Administration was construed to be the *alter ego* of the United States and

possessed of its sovereign privileges, priorities and immunities.

Whereas the Small Business Administration under its act of organization may in its own name, sue and be sued; enter into contracts, including contracts with the United States Government; buy and sell property; join with ordinary commercial lending institutions in making ordinary commercial loans to small business organizations; the Farm Credit Administration was determined not to be a commercial adventure but merely an arm of the Government (*U. S.* v. *Thomas*, 107 F.2d 765), which enjoyed immunity from suit (*Helms* v. *Emergency Crop & Seed Loan Office —Farm Credit Administration*, 216 N.C. 581, 5 S.E.2d 822), and actions on behalf of the Farm Credit Administration should be maintained in the name of the United States (*U. S.* v. *Fontenot*, 33 F. Supp. 629).

While numerous interesting questions were raised in *United States* v. *Emory*, 314 U.S. 423, and priority was accorded to a claim of the Federal Housing Administration in that case, the question here presented was neither raised nor determined by the Court in that case, and it certainly cannot be considered authority for so broad and sweeping a statement as is here made by the petitioner.

In *United States* v. *Marxen*, 307 U.S. 200, 83 L. Ed. 1222, the Court carefully pointed out that this issue was not raised and would not be determined. In that case only a single question was certified to the Court, and the Court said:

> "Although an amendment to the National Housing Act authorized the Administrator to sue and be sued in any Court of competent jurisdiction, State or Federal, it is not necessary in answering the present certificate to determine whether by this addition the Congress intended to give the Administrator the status

of a corporation or other entity distinct from the United States and by such status, to confer on or withhold from claims of the Federal Housing Administration against bankrupts the advantages of §3466. We can deal only with a claim of the Federal Housing Administration, assigned to the United States after the adjudication in bankruptcy of the obligor. It is assumed that such a claim belongs to and is made by the United States."

Since this question was not raised in the *Emory* case, and in view of the express reservation of this question in *Marxen*, neither case can be considered determinative of the issue here. It may even be doubted that the *Emory* case would be authority for a priority for the F.H.A. in a case where this question was in issue.

In the Korman case, the Court of Appeals for the District of Columbia examined the Congressional intent and determined that the Federal Housing Administration is not to be regarded as a separate legal entity from the United States. That case may be authority for claims of the F.H.A.; but not for the proposition that any non-incorporated agency must be regarded as the United States. On the contrary, it indicates that each agency must be considered separately and stand or fall from a consideration of the act creating it and the Congressional intent in connection therewith.

In *Sloan Shipyards Corporation* v. *United States Shipping Board*, 258 U.S. 549, 66 L. Ed. 762, the Court points out the enormous powers ultimately given to the Fleet Corporation and says that they have suggested the argument that it was so far put in place of the sovereign as to share the immunity of the sovereign from suit. The Court then reasons:

"Supposing the powers of the Fleet Corporation to have been given to a single man, we doubt if any

one would contend that the acts of Congress and the delegations of authority from the President left him any less liable than other grantees of the power of eminent domain to be called upon to defend himself in Court. An instrumentality of Government he might be, and for the greatest end; but the agent, because he is agent, does not cease to be answerable for his acts. * * *

"If what we have said is correct, it cannot matter that the agent is a corporation rather than a single man. The meaning of incorporation is that you have a person, and as a person one that presumably is subject to the general rules of law." (567).

The Court therefore held the Fleet Corporation not immune from suit. Concerning its claim for priority in bankruptcy the Court said:

"The claim was presented by the Fleet Corporation in its own name, but was put forward by it as an instrumentality of the Government of the United States. It was denied successively by the referee, the District Court, and the Circuit Court of Appeals, on the ground that the Fleet Corporation was a distinct entity, and that, whatever might be the law as to a direct claim of the United States, the Fleet Corporation stood like other creditors and was not to be preferred. 274 Fed. 893. The considerations that have been stated apply even more obviously to this case." (570).

A recovery in this case will be paid, not to the United States, but to the revolving fund of the S.B.A. While the administration is required to pay into miscellaneous receipts of the Treasury, at the close of each fiscal year, interest on the net amount of cash disbursements from advances, it is not required to make an accounting to the Treasury for its proceeds from individual loans as

such. A debt due to the S.B.A. is not a debt due to the United States.

An examination of the powers granted to the Small Business Administration clearly demonstrates that it was intended to be, and is a separate and distinct entity from the United States, and that debts due to the Small Business Administration are not "debts due to the United States" within the meaning of R.S. §3466.

CONCLUSION.

For all of the reasons hereinbefore set forth, the decisions below were correct and the judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

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SUPREME COURT OF THE UNITED STATES

No. 42.—October Term, 1960.

Small Business Administration, Petitioner, v. G. M. McClellan, Trustee.	On Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit.

[December 5, 1960.]

Mr. Justice Black delivered the opinion of the Court.

The Small Business Act of 1953 [1] created the Small Business Administration to "aid, counsel, assist, and protect insofar as is possible the interests of small-business concerns in order to preserve free competitive enterprise . . . and to maintain and strengthen the overall economy of the Nation." [2] The Administration was given extraordinarily broad powers to accomplish these important objectives, including that of lending money to small businesses whenever they could not get necessary loans on reasonable terms from private lenders.[3] When a part, but not all, of a necessary loan can be obtained from a bank or other private lender, the Administration is empowered to join that private lender in making the loan.[4] The basic question this case presents is whether, when the Administration has joined a private bank in a loan and the borrower becomes a bankrupt, the Administration's interest in the unpaid balance of the loan is entitled to the priority provided for "debts due to the United States" in R. S. § 3466 and § 64 of the Bankruptcy Act,[5] even though

[1] 67 Stat. 232, as amended, 15 U. S. C. §§ 631–651.

[2] 67 Stat. 232. [3] 67 Stat. 235–236. [4] *Ibid.*

[5] R. S. § 3466, 31 U. S. C. § 191, establishes a general priority for debts due to the United States. Section 64 of the Bankruptcy Act, as amended, 11 U. S. C. § 104, provides that in bankruptcy cases, the priority so established should come fifth in the order of preferred creditors.

the Administration has agreed to share any money collected on the loan with the private bank.

That question arises out of a joint bank-Administration loan of $20,000 to a small business, $5,000 of the loan having come from the funds of the bank and $15,000 from the Government Treasury. Nine months later, an involuntary petition in bankruptcy was filed against the borrower by other creditors. The Administration appeared in the proceedings upon that petition, filed a claim for $16,355.69, the amount then due on the loan, including interest, and asserted priority for its claim to the extent of $12,266.75, its 75 per cent interest in the debt. After a hearing, the referee in bankruptcy denied priority on the ground that the Administration is a "legal entity" and therefore not entitled to the "privileges and immunities of the United States." The District Court, on review, rejected the ground upon which the referee had relied but concluded that since the bankrupt's note evidencing the loan was not assigned by the bank to the Administration until after the commencement of bankruptcy proceedings, the debt is not entitled to priority.[6] The Court of Appeals affirmed on a third ground—that the Administration, having contracted to pay the participating private bank one-fourth of any distribution received, could not assert its priority and thus permit a private party to benefit from a priority which, under R. S. § 3466 and the Bankruptcy Act, belongs to the Government alone.[7] We granted certiorari to consider the Government's contention that the denial of priority to the Small Business Administration handicaps that agency in the effective performance of the duties imposed upon it by Congress.[8]

First. It is contended that the referee was correct in holding that the Small Business Administration is a sepa-

[6] 168 F. Supp. 483.
[7] 272 F. 2d 143.
[8] 362 U. S. 947.

rate legal entity and therefore not entitled to governmental priority in a bankruptcy proceeding. The contention rests upon a supposed analogy between this case and *Sloan Shipyards Corp.* v. *United States Fleet Corporation*,[9] and *Reconstruction Finance Corp.* v. *Menihan Corp.*,[10] in which cases this Court refused to treat the corporate governmental agencies involved as the United States. Neither of those cases, however, is controlling here. The agency involved in *Sloan Shipyards*, the Fleet Corporation, was organized under the laws of the District of Columbia pursuant to authority of an Act of Congress which "contemplated a corporation in which private persons might be stockholders." [11] This fact alone is enough to distinguish the Fleet Corporation from the Small Business Administration, which, as was contemplated from the beginning, gets all of its money from the Government Treasury. Our decision in the *Reconstruction Finance Corp.* case is equally inapplicable for that case involved only the question of whether the Reconstruction Finance Corporation, having been endowed by Congress with the capacity to sue and be sued, could be assessed costs in connection with a suit it brought. The holding that such costs could be assessed would not support a holding that the Small Business Administration is not the United States for the purpose of bankruptcy priority.[12]

[9] 258 U. S. 549.

[10] 312 U. S. 81.

[11] 258 U. S., at 565.

[12] The proper scope of that holding was recognized by Congress itself when, several years later, the Reconstruction Finance Corporation Act was amended expressly to deny the Corporation a right of priority except with respect to debts arising out of its wartime activities. Act of May 25, 1948, 62 Stat. 261. That the assumption underlying this amendment was that the Corporation would otherwise have had priority for all debts due to it is clear from the discussion of the purpose of the amendment in the Senate. Senator Buck stated that purpose as follows: "The committee believes that RFC should not

Thus neither of these cases requires us to hold that the Small Business Administration, an agency created to lend the money of the United States, is not entitled to all the priority that must be accorded to the United States when the time comes to collect that money. Under like circumstances we refused to deny priority for debts due to the Farm Credit Administration in *United States* v. *Remund*.[12] As was said there, of the Farm Credit Administration, the Small Business Administration is "an integral part of the governmental mechanism" [14] created to accomplish what Congress deemed to be of national importance. And it, like the Farm Credit Administration, is entitled to the priority of the United States in collecting loans made by it out of government funds.

Second. Respondent contends, as the District Court held, that the Small Business Administration's assertion of priority is precluded by our holding in *United States* v. *Marxen* [15] that priority attaches only to those debts owing to the United States on the date of the commencement of bankruptcy proceedings and not to debts that come into existence after that date. But this requirement of the *Marxen* case is fully met here by virtue of the fact that the debt due the Administration arises out of the loan made jointly by the bank and the United States nine months prior to the petition in bankruptcy. Since beneficial ownership of the three-fourths of the debt for which

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have such priority with respect to debts arising from its normal lending activities. A provision has been included in this section *which will eliminate that priority* except with respect to debts arising under the specific war powers which are designated therein." (Emphasis supplied.) Cong. Rec., 80th Cong., 2d Sess., Vol. 94, Part 3, p. 4108. See also *In re Temple*, 174 F. 2d 145.

[13] 330 U. S. 539.

[14] *Id.*, at 542.

[15] 307 U. S. 200.

priority is asserted belonged to the Administration from the date of the loan, it is immaterial that formal assignment of the note evidencing the debt was not made by the bank until after the filing of the petition.

Third. The Court of Appeals held, and the contention is reiterated here, that the Administration forfeited any right it might otherwise have had to priority by agreeing to turn over to the bank one-fourth of any distribution obtained because of its priority. By this arrangement, it is urged, the Administration is attempting "to give priority to a claim which the United States is collecting for the benefit of a private party," contrary to the principles announced by this Court in *Nathanson* v. *Labor Board.*[16] But the *Nathanson* case involved a significantly different situation. There the National Labor Relations Board sought to obtain governmental priority for back-pay claims belonging to employees based upon their loss of pay as a result of allegedly discriminatory discharges by the bankrupt. This Court's denial of priority in that case, involving claims in which the United States had no financial interest, would not justify a denial here where the money was loaned by, and the debt sought to be collected is due to, the United States. The fact that the Administration has contracted to pay the participating private bank one-fourth of any money it later collects on its loan does not mean the Government must lose its priority. Respondent's argument to the contrary seems to rest upon the assumption that the Government is deprived of its priority by making a contract to pay a part of its funds to another creditor of the bankrupt who has no priority. This argument finds no support whatever in § 3466, in § 64 of the Bankruptcy Act, or in the Small Business Act. Section 3466 declares in unequivocal language that the United States is entitled to priority "whenever any

[16] 344 U. S. 25, at 28.

person indebted to the United States is insolvent,[17] and § 64 recognizes that priority in bankruptcy proceedings. The purpose of these sections is simply to protect the interest of the Government in collecting money due to it.[17] Once that money is collected and placed in the Government Treasury, the end sought to be achieved by § 3466 and § 64 of the Bankruptcy Act is completely satisfied. At that point, there is no difference between the money so received and money received from any other source and, like other money, it may be disbursed in any way the Government sees fit, including the satisfaction of obligations already incurred, so long as the purpose is lawful. The Small Business Administration is authorized to enter into contracts calculated to induce private banks to make loans to small businesses.[18] The contract involved in this case, by providing additional security to the private bank at the Government's expense, is well adapted to that end. Indeed, in many cases such a contract may be the only way the Administration could induce private bank participation in a necessary loan. In those cases, acceptance of respondent's argument would make it more difficult for the Administration to perform its statutory duties. Clearly Congress did not intend, by the very act of imposing duties upon the Administration, to take away a privilege necessary to the effective performance of those duties.

Respondent's argument from the policy of equality of distribution for similar creditors expressed in the Bankruptcy Act [19] is no more convincing. It is true that the allowance of the priority asserted here will place the bank, a private unsecured creditor, in a better position than

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[17] For a discussion of the history and purposes of R. S. § 3466, see *United States* v. *State Bank*, 6 Pet. 29, 35–37. Compare *Nathanson* v. *Labor Board*, *supra*, at 27–28.

[18] 67 Stat. 236.

[19] 11 U. S. C. § 1 *et seq.*

other private unsecured creditors. But this position is a result, not of any inequality of distribution on the part of the bankruptcy court, but of the bank's valid contract with the Small Business Administration.

Fourth. Respondent's last contention, urged throughout these proceedings, is that governmental priority is inconsistent with the basic purposes and provisions of the Small Business Act. The contention rests upon the fact that having a creditor with governmental priority tends to make it more difficult for a small businessman to borrow money from other persons, and, in this respect, handicaps rather than aids borrowers, thus conflicting with the Act's basic policy. In *United States* v. *Emory*, we rejected this same argument, with reference to priority for Federal Housing Administration debts, stating that "only the plainest inconsistency would warrant our finding an implied exception to . . . so clear a command as that of § 3466." [20] The same conclusion must be reached here.

It was error for the courts below to refuse the Government's claim for priority.

Reversed and remanded.

MR. JUSTICE DOUGLAS dissents.

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[20] 314 U. S. 423, 433. See also *United States* v. *Remund*, *supra*, at 544-545; *Illinois ex rel. Gordon* v. *United States*, 328 U. S. 8, 11-12.